# The Economist

MAY 30TH–JUNE 5TH 2009

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How not to fix executive pay

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# Politics this week

May 28th 2009
From The Economist print edition

**North Korea** was roundly condemned after conducting a nuclear test, its second since 2006. It also carried out multiple missile tests. Soon after the UN Security Council met in emergency session, the North said it was abandoning the truce with South Korea that ended the Korean war and would attack the South if it searched North Korean ships as part of an American initiative to halt nuclear proliferation. See article

The **Pakistani Taliban** claimed responsibility for a complex bomb attack on the city of Lahore, saying it was retaliation for an army offensive against militants in the Swat Valley. The Lahore attack killed two dozen people. See article

Roh Moo-hyun, **South Korea's** president between 2003 and 2008, committed suicide by jumping of a cliff. Mr Roh's family is entangled in a corruption investigation. See article

The trial continued of Aung San Suu Kyi, **Myanmar's** opposition leader, for allegedly breaking the terms of her house arrest by offering hospitality to an uninvited American. John Yettaw, a Vietnam veteran, told the court he had a vision from God that Miss Suu Kyi would be assassinated by terrorists, and had gone to warn her.

A majority of members at the Geneva-based UN Human Rights Council celebrated **Sri Lanka's** victory over Tamil rebels and rejected calls for an investigation into alleged abuses on both sides. See article

## Enter stage left

Barack Obama nominated **Sonia Sotomayor** to the Supreme Court. An appeals-court judge, one of her most controversial decisions affirmed a lower court's ruling that white firemen couldn't be promoted because not enough blacks had passed a qualifying test. The Supreme Court is currently looking at the constitutionality of that case. If the Senate confirms her, Ms Sotomayor will be the first Hispanic appointed to the court, and only the third woman. See article

AFP


California's Supreme Court ruled that a ballot initiative passed by the electorate, defining marriage as between a man and a woman, was constitutional. But the court did not nullify the 18,000 **gay marriages** performed in the state in the six months before the ballot, a period when they were deemed legal. Proponents and opponents of same-sex nuptials promised another bout of balloting on the issue.

Arnold Schwarzenegger gave details of spending cuts needed to help close **California's** budget deficit. The state's governor said welfare benefits for around half a million families would have to go along with a health-care programme for low-income children. Ballot proposals addressing California's budget woes were recently voted down.

The debate over closing the prison at **Guantánamo** Bay showed no signs of abating. In a speech broadcast on May 21st Mr Obama explained why the camp's detainees should be transferred to federal prisons. Dick Cheney followed this with his own televised speech, in which the former vice-president defended the Bush administration's approach to national security. See article

## Town planning

Hillary Clinton, America's secretary of state, called on Israel to stop all **settlement activity** in the occupied West Bank, rejecting Israel's pleas to make allowance for the settlements' "natural growth".

Hundreds of supporters of the new **South African** president, Jacob Zuma, protested in Cape Town against Helen Zille, who leads the opposition Democratic Alliance. Dressed in army fatigues, veterans of the ruling African National Congress's former military wing complained of Ms Zille's criticism of Mr Zuma, which they said was racist.

Meanwhile, it was announced that South Africa had gone into **recession** for the first time since 1992, after the economy contracted at an annualised rate of 6.4% in the first quarter of 2009.

Barack Obama added Saudi Arabia to his **Middle East** itinerary. He will meet King Abdullah on June 3rd before giving a much-heralded speech the next day in Egypt, where he is to lay out his vision for America in the region.

## The foreign legion

Reuters

President Nicolas Sarkozy opened **France's** first military facilities in the Persian Gulf as part of a realignment of its overseas bases. France is stationing air, naval and ground forces in the United Arab Emirates to maintain a French presence in what Mr Sarkozy described as "the faultline for the whole world".

The opposition in **Georgia** became increasingly divided after weeks of protests demanding the resignation of President Mikheil Saakashvili, who lost a war with Russia last year. Protesters packed the 60,000-capacity national stadium to mark Independence Day. But one group, the National Forum, led by veteran politicians, said it would abandon the demonstrations. See article

Relations between **NATO** and **Russia** appeared to improve after rows earlier this month over the expulsion of two Russian diplomats deemed to be spies and NATO war games in Georgia. Ambassadors from Russia and NATO countries agreed to set a date for a meeting of their respective ministers. High-level talks have been suspended since Russia's war with Georgia.

## Lights out over the island?

**Cuba's** government said it would announce an austerity programme to cope with the effects of the global economic downturn and cut energy use to avert electricity blackouts this summer.

**Mexico's** army raided town halls and police stations in Michoacán, the home state of President Felipe Calderón, arresting a judge, ten mayors and several senior policemen suspected of links to drugs gangs.

The United States was due to impose new controls on its **border crossings** with Canada on June 1st, prompting worries from both sides of the frontier that they might hamper the movement of people and goods. See article

**Canada's** governor-general, Michaëlle Jean, helped to butcher a seal and ate a slice of its raw heart. She denied it was in protest at the European Union's proposed ban on importing Canadian seal products.

Authorities in **Brazil** said that month-long flooding in the north of the country had forced 400,000 people from their homes. Forecasters expect heavy rains to continue.

AP

## Business this week

May 28th 2009
From The Economist print edition

It was a big week for America's car industry. **General Motors** was expected to enter bankruptcy protection after the expiration of its offer to bondholders to exchange $27 billion in debt for a 10% stake in the company. GM wanted bondholders with 90% of the debt to accept the deal, but fell well short of that threshold. Meanwhile, Germany's government delayed a decision to pick a preferred bidder for GM's Opel division after GM sought more cash to keep Opel running. See article

A judge proceeded with a hearing on approving **Fiat's** proposed alliance and stake in **Chrysler**, which would speed the latter's exit from bankruptcy protection. Some of Chrysler's creditors lodged objections to the plan, arguing that their interests have been sidetracked in order to expedite the deal.

**Visteon**, a car-parts supplier, filed for bankruptcy protection. It hasn't reported an annual profit since splitting from Ford in 2000.

### The bonus-culture wars

Following similar action taken by rival banks, **Morgan Stanley** outlined changes to the way it awards senior executives by placing less emphasis on bonuses and making hefty increases to base salaries by way of compensation. The salary of John Mack, Morgan Stanley's boss, remains unchanged at $800,000. The decision comes as the Obama administration readies its ideas for reforming executive pay.

**Banco Santander** reached a settlement with the trustee seeking to recover money for clients of **Bernard Madoff's** Ponzi scheme. The Spanish bank agreed to pay $235m to square possible legal claims arising from its Geneva-based hedge-fund group.

India's **Bharti Airtel** and South Africa's **MTN** resurrected merger talks to create one of the world's biggest mobile-phone companies. The figures behind the potential deal are as impressive as they were around a year ago when previous discussions broke down: a combined 200m subscribers across India, Africa and the Middle East, annual revenue of $20 billion and a market value of around $60 billion. See article

### China puts its ore in

Rio Tinto agreed to cut the price of its **iron ore** by a third for Japan's steelmakers, a reduction that was immediately denounced as too timid by China's steel companies, which want to see prices lowered by at least 40%. The 40-year-old pricing mechanism for iron ore is under strain as Beijing pushes mining companies to move towards a more market-oriented approach.

**Royal Dutch Shell** restructured its business, reorganising its exploration and production, gas and power, and oil-sands units into two new divisions. The changes bear the authority of Peter Voser, the incoming chief executive.

**TNK-BP's** management difficulties continued. Russia's third-biggest oil company, a joint venture between BP and Russian investors, was beset by squabbles last year, leading to the resignation of Robert Dudley. This week it appointed an interim chief executive as shareholders decide who should get the job. Two candidates have emerged: Pavel Skitovich, who has worked for several industrial companies and is BP's preferred man, and Maxim Barsky, a director at a small oil company.

### Spring blossoms

A measure of American **consumer confidence** recorded its biggest increase since April 2003. The survey found fewer Americans, 44.7%, reporting that jobs were "hard to get" than in previous months. However,

only 5.5% said they intended to buy a car and 2.3% planned to buy a home.


Sales of existing **homes** in America rose by 2.9% in April, but were 3.5% below what they were in April 2008, according to the National Association of Realtors. Most of the uptick in sales took place in lower price ranges as more foreclosed homes came on the market.

**British Airways** followed its larger European rival, Air France-KLM, by reporting a net loss for its fiscal year. **Virgin Atlantic,** BA's arch-rival, seemingly bucked the trend when it said annual pre-tax profit had doubled. But using accounting standards applied to publicly listed airlines, Virgin's net income actually fell slightly. Both BA and Virgin were in no doubt that tough market conditions would hurt their profits for the current year.

A new figure was put on **Facebook's** value when it confirmed that a Russian group had invested $200m for a stake of nearly 2%, valuing the privately owned social-networking website at $10 billion. In October 2007 Microsoft bought a 1.6% stake, which valued Facebook at $15 billion. Analysts gave warning that, given the recent decline in share prices of tech companies on the stockmarket, a $10 billion valuation for Facebook may still be too optimistic.

# KAL's cartoon

May 28th 2009
From The Economist print edition

Illustration by KAL

**Government and business in America**

# Piling on

May 28th 2009
From The Economist print edition

**In his zeal to fix capitalism, Barack Obama must not stifle America's dynamism**

Illustration by KAL


DEFENDING American capitalism these days is a thankless job. Reckless lending by American financiers produced a crisis that has pushed the world into its worst recession since the 1930s. Tales of greed and fraud during the boom years abound.

Small wonder that although Americans still prefer their government neat and local, they are a little less hostile to federal activism these days (see article). Such sentiments, last November, helped propel Barack Obama into the White House and his Democratic Party to bigger majorities in both houses of Congress. As Rahm Emanuel, the president's chief of staff, says, Mr Obama does not want to waste this crisis. He is using it to create a bigger role for government throughout the economy, from education and health care to banking and energy.

He, and Congress, risk overreaching. America has experienced a failure of finance, not of capitalism. Its broader economy remains an astonishing Petri dish of creative destruction. Even in boom times, 15% of American jobs disappear each year. Their places are taken by new ones created by start-ups and expansions. This dynamism remains evident today, amid the most crushing economic conditions most businesses have encountered (see our special report in this issue). As icons of consumer excess like Starbucks and Neiman Marcus stumble, purveyors of frugality like Burger King and Wal-Mart prosper. Americans are adept at finding opportunity in adversity.

## Where government helps

The American economy is dynamic because Americans like it that way, even now. A Pew poll released on May 21st found that 76% of Americans agree that the country's strength is "mostly based on the success of American business" and 90% admire people who "get rich by working hard". These proportions have changed little in two decades, and they tend to produce government policies that make America, according to the World Bank, consistently one of the best places to do business.

Yet Mr Obama—and, even more, his Democratic allies in Congress—could do lasting damage to this marvellous machine. That is not because the president is a socialist, as his detractors on talk radio claim. No true leftist would be as allergic as he has been to nationalising tottering banks, nor as coldly calculating in letting Chrysler, and probably General Motors, end up in bankruptcy court.

Moreover, even the most stalwart defenders of the free market, including this newspaper, admit it has shortcomings that only the government can address. The financial system requires close oversight, or crises will destabilise it (see article). In recent years, such oversight has often been absent or fragmented. Only government can enforce competition rules, insist that business and consumers limit carbon-dioxide emissions, or intervene to make health care available to those too sick or poor to afford it. And the current crisis calls for aggressive and temporary fiscal and monetary intervention that is not justified in ordinary times.

But the Democrats' present zeal for government activism often goes well beyond addressing market failures. The president and Congress seem to believe that they can surgically intervene in the economy but overlook the unintended consequences. They are willing to demonise business when doing so furthers their aims. In one breath Mr Obama praises a bank that wrote down its claims on Chrysler and in the next lashes out at investors who, as was their right, did not.

Members of his team believe that tougher rules for business are necessary to cool voter anger that would otherwise result in even more vindictive measures. But rather than tamping down the backlash, they may only feed it. They aggravate that risk by outsourcing rule-writing to Congress, as with the fiscal stimulus and carbon emissions and, soon, health care. Congress is much more likely than the executive branch to let special interests or demagoguery shape the outcome.

## Creating new monsters

Too often, the result is overkill. Last December the Federal Reserve approved sweeping new rules on credit cards. Congress said it was not enough, and passed its own law which takes effect sooner and is even more restrictive. Some provisions restrain genuinely odious practices, such as charging interest on already-paid balances, but others prevent banks from tailoring interest rates to customers' changing risks.

The approach to energy is worse. Under a mammoth carbon-emissions bill now working its way through Congress, 85% of valuable permits to emit carbon dioxide (which might all have been auctioned) will be given away free. This creates a huge new pot of favours for government to hand out, and new incentives for businesses to lobby. It will be costlier to fight climate change, while harder to avoid political favour-trading.

Mr Obama's people seem sincere when they say they want to rid the government of its stakes in banks and carmakers as soon as possible. But in the meantime they are introducing new rules, such as limits on performance-related pay at banks, that could do more harm than good (see article). Nor can they resist using that ownership to push goals unrelated to the firms' welfare, such as pressing banks to relent on foreclosures or carmakers to make alternative-fuel cars for which there is no obvious demand. On top of that, they are passing more stringent fuel-economy standards that favour light trucks over cars. A far less distorting (and transparent) way to cut carbon emissions and raise fuel economy would be a carbon tax—but almost no one in Washington has the courage to propose one.

These mistakes matter because, for all Mr Obama's oratory, it will be very hard to reverse course in future. Regulations and interventions spawn constituencies that will fight any paring of their benefits. The federal government created Fannie Mae and Freddie Mac, the big mortgage agencies, in the interest of raising home-ownership. But long after that goal was met, the housing lobby barred almost all efforts to rein them in. Only massive taxpayer bail-outs have prevented their collapse.

America's free-market capitalism has always been a model for the rest of the world. By all means fix its flaws, Mr Obama; but do not take its dynamism for granted.

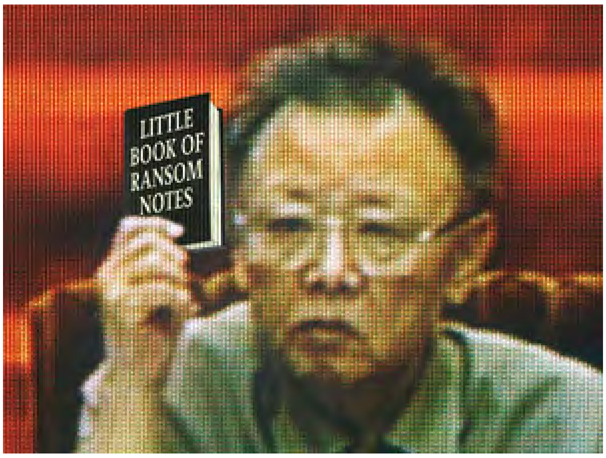
North Korea's nuclear spectacular

# Kim Jong Il's bombshell

May 28th 2009
From The Economist print edition

**Isolated it may be, but North Korea's antics do damage far beyond its own reach**

Reuters/Alamy




HE HAS been coaxed, cajoled, censured and sanctioned. Yet whenever it suits North Korea's boss, Kim Jong Il, he spews out new threats. For years he has managed to extort cash, oil and other goodies for then quietening down, only to behave even more threateningly next time. Can nothing be done to make this serial rule-breaker blink?

With his second nuclear test and multiple missile launchings (see article), North Korea's Dear Leader has ignored the hand that President Barack Obama has said he is ready to extend to America's erstwhile enemies. He has also delivered a nuclear-powered slap in the face to China, his semi-backer and the chief proponent for the past six years of a strategy of come-what-may patience, negotiation and perks in an effort to humour Mr Kim out of the bomb business. But patience is not always a virtue in dealing with a regime as practised at blackmail as Mr Kim's. For unless he now pays a seriously high price for his defiance, the message heard by others, particularly Iran, still mulling how far they should push their own nuclear plans is that they too can have a bomb—if they are prepared to be belligerent enough, for long enough.

## Watch what he does, not what he says

Mr Kim has long played the nuclear game by his own rules. The aim of the other five around the negotiating table—America, South Korea, Japan, China and Russia—has been to get him to shut down his bomb factories and (after steadily increasing dollops of trade and investment, and in return for diplomatic ties with America) eventually to give up the bombs he has long claimed to have stashed away. Indeed, Mr Kim has promised, more than once, to do just that. Yet he has dragged out the process at every turn. It came as little surprise to those who always doubted his disarming intentions that the six-party talks came badly off track last year just at the point where tight verification rules were to be agreed upon so that outsiders could check that his promises were kept.

Now Mr Kim says he will "never" go back to the six-party talks. He wants North Korea to be accepted as a nuclear power, his officials say, just as India in practice has been. But you can be sure of one thing if the capricious Mr Kim is persuaded back to the table. With a second nuclear blast to boast of, the price will have gone up yet again. How does he get away with it? And does it really matter that such an isolated and impoverished contrarian keeps breaking all the anti-nuclear rules?

Mr Kim does not need his bombs to wreak havoc in South Korea, whose capital, Seoul, has long been

within range of the North's artillery dug into the hills just over the border. Rather, he needs a "deterrent", he says, to fend off a hostile America. And yet this latest nuclear test surely destroys North Korea's best chance in years to get on friendlier terms with the country it claims to fear most. That in turn leads dogged optimists to argue that this may be nothing more than a temporary diplomatic setback after all: the ailing Mr Kim needs the backing of nuclear hardliners in the armed forces, they explain, to steady the regime while he lines up one of his sons to take over the family dynasty.

The thought should bring little comfort. For whether he is trying to hang on to power at home, or determined to cock an enduring nuclear snook at the world, makes little difference when Mr Kim clearly feels he has licence to bang on regardless and get away with it. He has shrugged off past half-hearted sanctions imposed on him by the United Nations Security Council and others. He knows that, whatever he does, some food aid will keep flowing in, since outsiders care more than he does for the plight of his often malnourished, sometimes starving, people. And he calculates that China, which controls most of the oil taps to North Korea, is fearful of a swelling influx of refugees if the economy collapses further. China says it "resolutely" opposes Mr Kim's latest nuclear and missile tests, but continues to oppose the sort of truly punishing sanctions that could make Mr Kim ponder the error of his ways.

With China's misguided protection, the harm the radioactive Mr Kim is doing just goes on spreading. There will be no stability in East Asia until he can be induced to cease his nuclear antics. His tests of increasingly sophisticated rockets were causing alarm in Japan—and talk of "rearmament" in some quarters there—even before hints that he is perfecting missile-mountable nuclear warheads to put on them.

Leaving Mr Kim free to demonstrate his nuclear wares also increases the danger that he will find new customers for them. North Korea had already secretly built a nuclear reactor in Syria before Israel destroyed it in an air raid. Before that some of Mr Kim's nuclear material had turned up in Libya, via the nuclear black market, before that country handed in all its bomb-making paraphernalia. A well-tested warhead design is both easier to hawk and more lucrative to sell.

North Korea is known to work closely with Iran on building nuclear-capable missiles. No one knows where their co-operation stops. Unlike Mr Kim, Iran insists it has no use for the bomb. Yet suspicions have mounted as Iran has invested in expensive technologies for enriching uranium and making plutonium (both possible bomb ingredients) before having a civilian nuclear-power industry that can make peaceful use of them. And though it claims to co-operate with UN inspectors, Iran refuses to answer their questions about studies and past experiments that have little or no plausible civilian purpose.

## The fallout to come

But even if North Korean and Iranian scientists have kept their nuclear distance, the example Mr Kim sets and the failure of the UN, America, China and others collectively to do more than inconvenience him with trade restrictions on fast cars and Rolex watches will only cause Iran's suspicious neighbours, like North Korea's, to worry that time and the world's anti-nuclear rules are not on their side. Unless North Korea is checked, the fear and suspicion Mr Kim has created could set off a chain reaction of proliferation. If China is at all serious about joining America as a global leader, this is the time for it to shoulder its responsibility by helping to punish Mr Kim.

## Fighting the Pakistani Taliban

# A necessary catastrophe

May 28th 2009
From The Economist print edition

**To fight militancy, Pakistan needs to conquer its radicalised north-west, then govern it**

Getty Images

A CATASTROPHE is unfolding in Swat, a picturesque region of Pakistan's North-West Frontier Province (NWFP) once loved by honeymooners. Nearly 2.4m people are reported to have fled an army offensive against Taliban militants, launched early this month at America's behest. Thousands of civilians are trapped, with dwindling supplies of clean water and food. Hundreds are alleged to have been killed or maimed. On the evidence of two previous offensives in Swat, this may achieve nothing good. It risks leaving Swatis even angrier with their government and more vengeful than before, hardening the Taliban's hold over the region. In a country as unstable as Pakistan, it is tempting to fear, America's new foreign-policy chiefs should be more careful what they ask for.

For all that, the government was right to take military action to drive the Taliban from Swat. The most economically developed area of Pakistan in militant hands, it has long been prime evidence for those who accuse the government of scarcely trying to quell the militancy sweeping the north-west of the country. Unlike the semi-autonomous tribal areas adjoining NWFP, many of whose Pushtun inhabitants fight for the Taliban on both sides of the border with Afghanistan, Swat has a semblance of a functioning state. Its better-educated people have no love for the Islamist hooligans in their midst. Yet the army's stuttering campaigns, and a recent effort to appease the militants by offering to institute Islamic law in Swat and other parts of NWFP, have strengthened their control over it.

One reason for optimism is that, on early signs, this offensive is more serious than its forebears in Swat and elsewhere (see article). During the army's last fight in Swat, which ended in February, a small force tried to drive the Taliban from Mingora, the district's biggest city, with shellfire. This resulted in many civilian deaths and local fury. With a bigger force, including 6,000 soldiers reportedly shifted from the Indian border, the army now seems to be fighting more carefully.

Another hopeful sign is that many Pakistanis claim to support this offensive. Hitherto, most have considered the army's war against the militants as a regrettable service to America. But recent Taliban excesses, including their well-publicised flogging of a teenage girl, have convinced many that the Islamists need pegging back. The Urdu media, which are roundly anti-American, back this offensive, and the main political parties have declared their support. To keep that consensus and confound the Islamic parties which remain outside it, the army must redouble its efforts to minimise civilian casualties and the government must do more to care for the displaced.

## After the battle, prove you're a state

But if the offensive is to mark a real turning-point in Pakistan's flailing war against the Taliban, the

government needs above all to train and equip NWFP's police and local administration to control the ground its soldiers have cleared, and to oversee the economic development that must follow. The government's failure to plan for this in the past, far less achieve it, has been the main reason for the Taliban's recent successes.

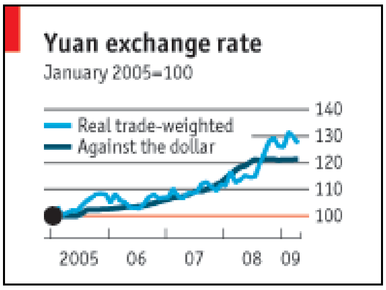
Given the weakness of Pakistan's civil institutions, this is a daunting task. In the tribal areas, where the army is expected to resume campaigning after it finishes in Swat, and where the state is currently a figment, addressing it will require serious thought. Unless it attends to these basics, Pakistan will neither turn back the Taliban tide nor retain popular support for its effort. Even now, few Pakistanis may consider the Taliban to be the existential threat to their country America says it is. But all Pakistanis can appreciate the merits of having better government. Pakistan has to show it can provide one.

China, America and the yuan

# Time for a Beijing bargain

May 28th 2009
From The Economist print edition

**Sino-American economic policy needs a new start. Tim Geithner's visit to China provides an opportunity**




HOW times change. When George Bush's treasury secretaries first visited China, Wall Street was booming, America's economy was growing and the president's emissaries routinely lectured their Chinese hosts on the need for freer financial markets and a more flexible yuan. But as Tim Geithner, the current treasury secretary, prepares to make his maiden trip to Beijing on May 31st, Wall Street is synonymous with greed and failure, America's economy is on its knees and it is the Chinese who have been doing the lecturing. With America's budget deficit soaring and the Fed's printing presses running at full speed, China is complaining loudly of the risks that inflation and depreciation pose to its huge stash of dollars, and arguing for an alternative to the greenback as the world's reserve currency.

The tables may have turned, but the dynamics on both sides of the Sino-American economic relationship are remarkably similar. The lecturing tone is driven largely by politics at home. Just as American treasury secretaries needed to shout loudly about China's currency in order to appease a potentially protectionist Congress, so Beijing officials must hector Americans about their profligacy to assuage rising domestic fury about the losses China faces on its reserve holdings. On both sides, the most egregious posturing is economically illiterate. America's bilateral trade deficit with China does not prove that Beijing manipulates its currency, as many congressmen have argued. And despite the huffing in Beijing, the losses that China faces on its reserve portfolio have more to do with its own policy choices than America's spendthrift ways.

## Courageous choreography required

Both China and America should use Mr Geithner's three-day visit to set a new tone in which co-operation replaces rhetoric. The two countries need to act on a broad economic agenda from global warming (real progress is impossible without co-operation between the world's two biggest carbon emitters) to funding the expansion of the International Monetary Fund (China has yet to come up with any cash and Congress has not authorised the $100 billion promised by the Obama administration). The priority, however, should be a healthier macroeconomic relationship between the world's biggest sovereign borrower and America's largest creditor. What is needed for a sustainable global recovery is well known. China must foster private-sector domestic demand with a stronger currency, among other things. And America must lay out a credible route to the eventual unwinding of its massive stimulus.

In today's febrile markets any misstep could cause the dollar to tumble and Treasury yields to soar further. So the moves must be carefully choreographed. China should be more forthright on the yuan. After a welcome appreciation alongside a stronger dollar in 2008, China's currency has fallen on a trade-weighted basis in recent weeks as the dollar has tumbled. Mr Geithner's hosts should make it clear that even if the dollar continues its slide against other currencies, the yuan will not follow suit. Instead it will gradually appreciate. To forestall any additional surge in Treasury yields, Mr Geithner should elaborate on how the Obama administration intends to cut spending and raise tax revenue in the medium term.

It will take political courage for the Chinese to eschew a weak currency and for an American treasury secretary to unveil fiscal details in Beijing. But the parlous state of the world economy demands nothing less.

**Computing**

# Unlocking the cloud

May 28th 2009
From The Economist print edition

**Open-source software has won the argument. Now a new threat to openness looms**

Illustration by Claudio Munoz

"FIRST they ignore you, then they laugh at you, then they fight you, then you win." Mahatma Gandhi probably never said these words, despite claims to the contrary, but they perfectly describe the progress of open-source software over the past 15 years or so. Such software, the underlying recipe for which is created by volunteers and distributed free online, was initially dismissed as the plaything of nerdy hobbyists. Big software firms derided the idea that anyone would put their trust in free software written by mysterious online collectives. Was it really secure? Whom would you call if it went wrong?

At the time, selling software to large companies was sometimes likened to drug dealing, because once a firm installed a piece of software, it had to pay a stream of licence fees for upgrades, security patches and technical support. Switching to a rival product was difficult and expensive. But with open-source software there was much less of a lock-in. There are no licence fees, and the file formats and data structures are open. Open-source software gained ground during the dotcom boom and even more so afterwards, as a way to cut costs.

Microsoft, the world's biggest software company, went from laughing at the idea to fighting it, giving warning that there might be legal risks associated with using open-source software and even calling it a "cancer" that threatened to harm the industry. Yet the popularity of open-source programs such as the Linux operating system continued to grow. The fact that Google, the industry's new giant, sits on a foundation of open-source code buried the idea that it was not powerful or reliable enough for heavy-duty use. One by one the industry's giants embraced open source. Even Microsoft admits that drawing on the expertise of internet users to scrutinise and improve software has its merits, at least in some cases.

The argument has been won. It is now generally accepted that the future will involve a blend of both proprietary and open-source software. Traditional software companies have opened up some of their products, and many open-source companies have adopted a hybrid model in which they give away a basic version of their product and make money by selling proprietary add-ons (see article). The rise of software based on open, internet-based standards means worries about lock-in have become much less of a problem.

## Clouding the picture

But now there is the danger of a new form of lock-in. "Cloud computing"—the delivery of computer services from vast warehouses of shared machines—enables companies and individuals to cut costs by handing over the running of their e-mail, customer databases or accounting software to someone else,

and then accessing it over the internet. There are many advantages to this approach for both customers (lower cost, less complexity) and service providers (economies of scale). But customers risk losing control once again, in particular over their data, as they migrate into the cloud. Moving from one service provider to another could be even more difficult than switching between software packages in the old days. For a foretaste of this problem, try moving your MySpace profile to Facebook without manually retyping everything.

The obvious answer is to establish agreed standards for moving data between clouds. An industry effort to this effect kicked off in March. But cloud computing is still in its infancy, and setting standards too early could hamper innovation. So buyers of cloud-computing services must take account of the dangers of lock-in, and favour service providers who allow them to move data in and out of their systems without too much hassle. This will push providers to compete on openness from the outset—and ensure that the lessons from the success of open-source software are not lost in the clouds.

# On animal testing, the news, New Orleans, northern Cyprus, Israel, boss-napping, Thatcherism, Tom Joad, MPs' expenses

May 28th 2009
From The Economist print edition

## Of mice and men

SIR – Your leader on animal experiments stated that scientists "usually publish the results of their research only if they are positive, but if there is more data about negative results, scientists are less likely to repeat experiments needlessly" ("Suffering for science", May 9th). The standard for any experiment remains basic hypothesis testing, where the responses of individuals exposed to a given treatment are compared with those from individuals exposed to a negative control.

The hypotheses being tested are the null hypothesis, where there is no difference between the responses of individuals exposed to either the treatment or control, and the alternative hypothesis, where a difference occurs. But if the null hypothesis is supported, one cannot conclude that the treatment itself is responsible for the lack of a significant effect. It may be down to a variety of reasons, including a poorly designed experiment. It is for this reason that editors of peer-reviewed literature are less likely to publish these so-called negative results. Good scientific practice would call for further research and experiments.

Trenton Garner
RCUK fellow
Institute of Zoology
London

SIR – You asserted that "animal studies can sometimes be of dubious scientific value, since different species react differently to the same procedure" ("Catheter and mouse", May 9th). These differences, however, can be a valuable source of information. You also ask scientists who use animals to share data. In practice, scientists already share data; we like to talk about our research, even the experiments that don't work. From my experience, I doubt that many scientists are busy duplicating the failed experiments of others. And, as you noted, duplicating positive experiments is crucially important. How many seemingly breakthrough findings have disappeared after replication proved impossible?

M.W. Anders
Professor and chair emeritus
Department of pharmacology and physiology
University of Rochester Medical Centre
Rochester, New York

## Worth reading

SIR – I was surprised to read, in your leader on the future of news, such a wrongheaded view of the purpose of your business: "a package of content…which exists to attract eyeballs to advertisements" ("The rebirth of news", May 16th). You said this, even though you also recognised the purpose of news in a democracy. Surely you should think of ads as simply one way of providing resources to your business. Reporting the news meets a genuine human need. Maybe if you looked at it this way it would be easier to find an online business model that works.

Incidentally, I founded and run a business on the internet that helps homeowners find reliable tradesmen. We charge both subscription and transaction fees to trade professionals. I'm glad I don't think of my business as a transaction engine that attracts homeowners solely in order to justify the fees inflicted on our tradesmen. I'd be unlikely to get out of bed in the morning.

Ryan Notz
Chief executive

MyBuilder.com
London

## Urban regeneration

SIR – I know that bad news sells newspapers, but your article on New Orleans was a bit exaggerated ("City of sickness", May 16th). You reported that a quarter of the population never returned after Hurricane Katrina. That is based on the city limits, not the greater metropolitan area. Taking the latter, the current population is 87% of what it was before Katrina struck, and is rising as more people return or move here for the first time. A similar caveat applies to your figure for empty homes; large parts of Jefferson parish did not flood and have much lower rates for abandoned property. With regard to the poverty rate, your interpretation is misleading. You implied that it rose after Katrina. In fact, federal spending on the recovery effort led to an increase in employment at the end of 2008 at a time when unemployment was rising in the rest of the country.

I suspect that if the fair city of London were to suffer a calamitous flood, *The Economist* would be conscientious in describing the positive as well as the negative aspects of its subsequent recovery. New Orleans has come a long way since Katrina. There is sickness here, but also joy and constant, gradual rebuilding.

Anthony Pereira
Professor of political science
Tulane University
New Orleans

## Northern Cyprus

*SIR – Your article on the election in northern Cyprus ("A hawkish problem", April 25th) correctly identified as a major issue the restrictions on our trade and communications with the rest of the world. After we voted to accept the United Nations settlement plan in 2004, the UN secretary-general said "the Turkish Cypriot vote has undone any rationale for pressuring and isolating them".

In Britain, the House of Commons Foreign Affairs Committee said: "undertakings given to Turkish Cypriots by the international community must be honoured. We recommend that the government do more to turn its words into action".

The European Union Council said in its decision of April 26th 2004, right after referendums on the island, that "the council is determined to put an end to the isolation of the Turkish Cypriots through direct trade regulation and to facilitate the reunification of Cyprus by encouraging their economic development."

Turkey has made it clear that it will open its ports to Greek Cypriot ships when the isolation of the Turkish Cypriots is lifted, and not before. Nobody should support any arguments to the contrary.

Kemal Koprulu
London representative
Turkish Republic of Northern Cyprus
London

## Israel and the road map

*SIR – Your leader on America and Israel stated that Binyamin Netanyahu "accepts Mr Bush's 'road map' that led nowhere but clearly affirmed a two-state solution" ("Don't hold back", May 16th). This is disingenuous. There are 14 "reservations" that the Israelis consider to be integral parts of the road map.

Reservation five, for instance, says: "The provisional state will have provisional borders and certain aspects of sovereignty, be fully demilitarised...be without the authority to undertake defence alliances or military co-operation, and Israeli control over the entry and exit of all persons and cargo, as well as of its air space and electromagnetic spectrum."

The syntax of the reservation is uncertain, but it is clear that such a state will be a sort of Palestinian bantustan, a farcical territory at the mercy of the Israeli puppeteers with only the power to issue its own pretty stamps.

Fabrizio Galimberti
Hawthorn, Australia

*SIR – The claim that Israel's long-term security is tied to the creation of a viable Palestinian state is negated by the experience following Israel's disengagement from Gaza in 2005. Despite Israel's total withdrawal, rocket strikes from Gaza have increased by more than 500%. Disengagement decreased Israel's security; it did not enhance it.

You also gloss over certain problematic sections of the Hamas charter: calls for the destruction of Israel (preamble); the eradication of all Jews (article 7); the assertion that peaceful solutions are futile (article 13); and condemnation of the Egypt-Israel peace agreement (article 32). Hamas is unlikely to accept Israel or to work towards a sustainable peace agreement today, tomorrow or ten years from now.

Edie Molot
Bellevue, Washington

## Smooth industrial relations

SIR – How uncivilised, if the wave of "boss-napping" in France is indeed sinister ("*Vive la différence!*", May 9th). It was different in West Bengal in the 1970s, when the Communists took power. One afternoon, a colleague was informed that he and I would be *gheraoed* (surrounded, literally) at close of day by the staff at the Calcutta office in protest at our regressive management policies. Alarmed at what would be a delayed start to the usual whisky session at our club, we negotiated and were granted permission by the protesters to leave early, go home to shower, change into comfortable clothing and return suitably armed with our favoured libation.

And so we spent our evening surrounded by 35 staffers who made impassioned speeches and gave high-decibel calls for death to capitalists as we depleted a bottle of Black Knight. It didn't much improve the taste of the whisky, and the calls for our demise did at times seem over the top. But sinister? Not at all.

Stanley Pinto
Bangalore, India

## Maggie out

SIR – Bagehot's claim about "the permanence of Thatcherism" is wrong (May 9th). The heart of Thatcherism, which underlined all Margaret Thatcher's policies, was that government and the public sector were the problem, and markets and business were the solution. Thatcherism has expired because, in the wake of government bail-outs of the global market economy, it would be impossible for any serious person to maintain this central Thatcherite dogma with a straight face.

Neil Pearse
London

## Literary critic

*SIR – Regarding your article on labour mobility ("The road not taken", March 21st), you say that "in 'The Grapes of Wrath', when Tom Joad's farm in Oklahoma was repossessed he packed up his family in a sputtering truck and set off for California."

In John Steinbeck's novel, the Joad family were tenant farmers, or sharecroppers. Thus the family did not own the farm, so it could not be "repossessed." Their landlord evicted them. The landlord took control of the farm because New Deal agricultural legislation subsidised landlords to farm large areas with tractors, rather than to keep tenants in place.

Furthermore, Tom Joad was neither the tenant nor the head of the family. Pa Joad was. In the book, eldest son Tom returns from prison after the family has been evicted and joins them on the trip to California.

Sorry to be so late with this information, but I knew you'd want to get it right.

John Thompson
Durham, North Carolina

## An Olympic ideal

SIR – Without wishing to add fuel to the raging conflagration regarding MPs' expenses, there is a perfectly egalitarian solution to the important issue of finding accommodation in London for our hard-working, away-from-home members of Parliament ("Political climate change", May 23rd). The London Olympics will create thousands of apartments for athletes and officials. Offer these rent-free to MPs and, hey presto, no more charging for second homes. I think MPs will appreciate the chance to mingle with other, hard-working public servants at the end of the workday, while helping the Treasury to pay down part of our trillion-pound debt.

Nigel Williams
Chester

SIR – It is nice to hear that at least one MP made good use of his expenses. Massage chairs and pornographic films are all well and good, but only a well-maintained moat will offer any protection from one's constituents.

Jamie Michener
San Francisco

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*Letter appears online only

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*Letter appears online only

Government v market in America

# The visible hand

May 28th 2009 | INDIANAPOLIS AND WASHINGTON, DC
From The Economist print edition

**Americans have grown slightly more receptive to the idea of an activist government. Will they go along with Barack Obama's aspirations?**

Alamy

THE demonstrators thronging the steps of the war memorial in central Indianapolis are a small but spirited bunch. Steps away from the head office of one of the country's biggest health-insurance companies, they chant slogans calling for a single government-run health plan and wave signs with slogans like "One plan one nation" and "Patients not profits". One cheekily advises: "Accept personal responsibility. Do your own colonoscopy". After pursuing their cause for years, advocates of universal health care got a jolt of energy when Barack Obama took office. "Something happened in January that changed our cultural story for ever," a folk singer tells the crowd before launching into a song, "If not now, tell me when."

Across the street, an argument breaks out. Dennis Majewski, a public-defence lawyer, agrees with the protesters. "We'll never rebound until we have national health-care insurance." But should the government look after "a known druggie whose drug habit gets him to the point he is seriously ill?" queries his cousin, Tom Majewski, a retired executive. Well, yes, says Dennis: "That person has a serious illness." Tom shoots back: "But it's a choice!"

The debate in Indianapolis is a microcosm of a broader re-examination by Americans of government's role in the economy. Private risk-taking run amok has plunged the country into its worst recession in decades. Partly in response, Mr Obama and Congress are exploring ambitious new ways to expand the government's responsibilities.

Mr Obama has been elusive on where he believes the boundary between government and the market should be. "The question we ask today is not whether our government is too big or too small, but whether it works," he said in his inaugural address. Yet his actions belie that agnosticism. Most of the big domestic initiatives taken since he became president involve expanded federal-government activity, either temporary or permanent. They include more oversight over the financial system and executive pay, extending health insurance to the 15% of Americans who lack it, shifting energy consumption from fossil to renewable fuels, and redistributing income from the wealthy to the middle-class.

Congress is even more unabashedly activist. On May 22nd it passed by overwhelming majorities the most sweeping crackdown on the credit-card industry in decades. Even its name, the “Credit cardholders’ bill of rights”, suggests not just a set of rules but a treaty between business and the people. Now that credit cards are as vital to life as telephony or electricity, they will be regulated as such.

But are Mr Obama and Congress in tune with America? Laissez-faire has clearly lost some lustre since Ronald Reagan was president. Yet a survey by the Pew Research Centre, released on May 21st, shows that Americans still like business. It found that 76% agree that the country’s strength is “mostly based on the success of American business”, and that 90% admire people who “get rich by working hard”, proportions that have changed little in two decades. People are, however, jaded by business’s excesses: just 37% of respondents believe that business strikes the right balance between profits and public interest, the lowest proportion since Pew began asking the question in 1987.

This undoubtedly helped fuel the country’s shift to Democrats in the last two elections. Indiana, solidly Republican for years, has recently become a swing state. In 2006 its nine seats in Congress shifted from 7-2 in favour of Republicans to 5-4 in favour of Democrats. Mr Obama carried it in the 2008 presidential election, the first time a Democrat had done so since 1964.

On the other hand Mitch Daniels, Indiana’s Republican governor, was re-elected by a wide margin. Mr Daniels suggests it is too soon to say that Americans want bigger government. Indiana voted for Mr Obama because it wanted change. “He got a significant crossover vote in the Republican suburbs,” admits Mr Daniels. But he goes on to say: “Those people did not become French in the last five months.” He argues that Mr Obama will lose the state in 2012 if he pursues what the governor derisively calls “shock and awe statism”, such as the caps on carbon emissions that are so unpopular in coal-reliant Indiana.

Polls back him up: Pew finds that Americans still think the federal government controls too much of their lives. Andrew Kohut, president of the Pew Research Centre, sees a parallel with 1981, when polls showed high approval for Reagan coupled with anxiety about his policies, such as cuts to Social Security (government-funded pensions) and welfare. Reagan may have wanted to push the country further right than it wanted to go. In 1982, with the economy deep in recession, voters punished the Republicans in the elections.

Polls show that the increased trust in government is almost entirely limited to Democrats. Republicans are more distrustful, and the views of independents have not changed much. This seems to suggest that what looks like increased faith in government is actually faith in Mr Obama. Yet history suggests that many of Mr Obama’s expected moves towards big government, however controversial they may be, will in the end turn out to be permanent.

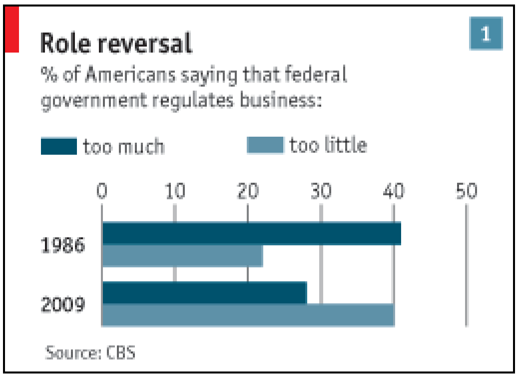
## A history lesson

Americans trace their mistrust of government to their roots. The country was founded by refugees from state-sanctioned religious persecution who later revolted against English-imposed taxes. “The natural progress of things is for liberty to yield and for government to gain ground,” said Thomas Jefferson. Henry David Thoreau, writing some years later, mused: “I heartily accept the motto, ‘That government is best which governs least’…It finally amounts to this, which also I believe, that government is best which governs not at all.”

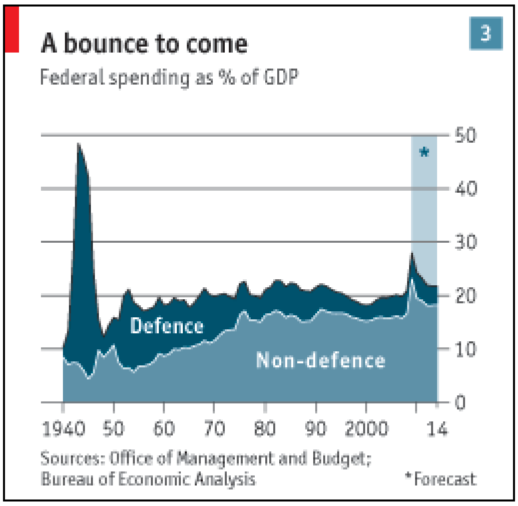
This self-portrait, however, has always been as much mythology as fact. The constitution, often portrayed as designed to shackle government, actually imposed a structure that the earlier Articles of Confederation lacked, notes Garry Wills, a historian. “We are pious toward our history in order to be cynical toward our government,” he wrote in “A Necessary Evil”. Thoreau’s anti-government, anti-tax crusades captured American sentiment, but he never had much of a following.

The federal government was tiny for much of the first century of the country’s existence, then expanded steadily. Industrialisation and unionisation led to an era between the 1890s and early 1920s that brought antitrust laws, regulation of interstate commerce, income tax and the regulation of food and drug quality. Price Fishback, an economist at the University of Arizona, writes that the ideological bias against government began seriously to retreat in the face of the Depression and the two world wars, so that “by 1950 the majority of elites and the general public easily turned to government when they saw a problem they thought should be solved.”

Crises usually bring about clamour for more government. It sometimes shrinks afterwards, but never back to its original size. The federal government first issued a national currency to finance the civil war. Financial panic in 1907 led to the creation of the Federal Reserve in 1913. The Depression led to the creation of the Securities and Exchange Commission and the Federal Deposit Insurance Corporation to safeguard the financial system, and the Federal National Mortgage Association (Fannie Mae) to develop a national mortgage market. The federal safety-net came into existence with Social Security and unemployment insurance. The second world war cemented the conviction that an active government was needed to preserve full employment, a belief that was codified in the 1946 Employment Act.




The first concerted effort to roll back some of this power began under Jimmy Carter with the deregulation of airlines, transport and banking. Reagan turned the trend into a governing philosophy, declaring on becoming president in 1981 that: “Government is not the solution to our problem; government is the problem.” In 1986 a CBS News poll found 41% of respondents thought the government regulated business too much and 22% thought it regulated it too little (a view that has now been reversed; see chart 1). Reagan’s enduring legacy was to entrench lower taxes as part of small-government philosophy. Lower taxes seized the public’s imagination in a way that deregulation never has. Even so, the government did not actually shrink under Reagan; it merely stopped growing. Federal spending, excluding defence, grew from less than 5% of GDP at the outset of the Depression to around 16% in the late 1970s, and has remained there until now (see chart 3).




For the next two decades, small government remained the stated preference of presidents, including Bill Clinton, who in 1996 declared that “the era of big government is over.” Though there was only a little true deregulation in this period, financial innovation grew most where regulation was lightest. The fastest-growing derivatives, for example, were not covered by commodity-futures laws, and the fastest-growing subprime lenders were not banks and thus not federally regulated.

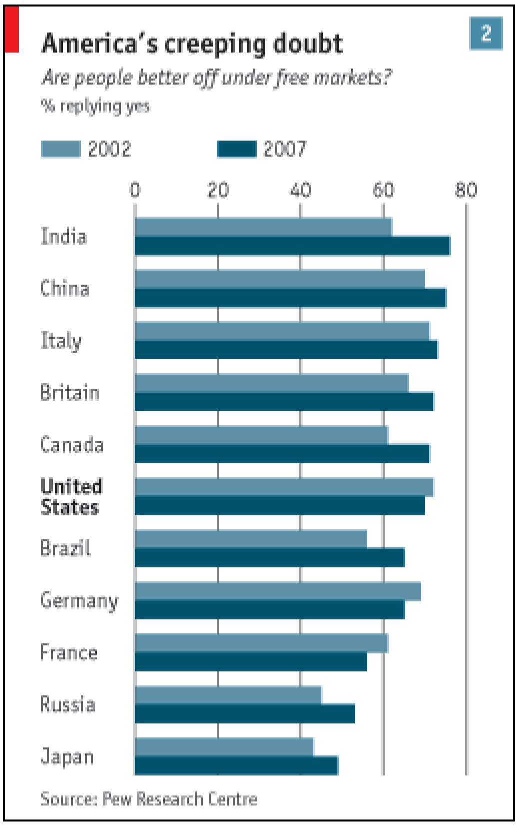
The swing back towards more activist government began under George Bush, partly in response to new crises. The terrorist attacks in 2001 led to the creation of the Department of Homeland Security, the Patriot Act, the federalisation of airport security, an expansion of money-laundering rules and federally subsidised terrorism insurance. The stockmarket collapse led to the Sarbanes-Oxley act overseeing corporate governance and accounting standards. Mr Bush was happy to expand government in order to maintain Republican hegemony so long as he could also cut taxes; that this meant a larger budget deficit was not a priority for him. He thus introduced a costly drug benefit for the elderly.

Household income stagnated as energy and health-care costs rose and more of the gains in income went to the wealthy. One result was that Americans, traditionally fonder of the free market than the rest of the world, became less so. In 2007 an international survey by Pew found that American support for free markets had edged down from five years earlier. Yet in most countries it rose, especially in the developing world (see chart 2). The globalisation that had benefited them so much had unsettled Americans, many of whom blamed stagnant wages on competition from poorer countries.

Thus the arrival of the financial crisis found Americans already souring on unconstrained capitalism. Luke Kenley, an influential state senator from Indiana, sees a philosophical divide along generational lines. People over 50, such as himself, “have a great comfort level with the American free-enterprise system”, and recognise the current turmoil as the marketplace correcting its own previous excesses.

But his own grown-up children do not share that faith. His son John, a lawyer aged 38, suggests that “Reagan had a time and a place, but those messages don’t resonate.” The disaster in the housing and mortgage markets shows that free markets don’t

always get incentives right or generate the information people need to make wise decisions. There may be times, he adds, when government is better suited to giving people the information they need.




The financial crisis propelled Mr Obama into the White House and he has aggressively exploited the opportunity. Some of the ways are obvious: he is using the government's ownership stakes in banks to change how they pay their executives, and its control of General Motors and Chrysler to boost their production of cars that use alternative fuels.

Mr Obama explained his thinking on May 22nd on C-Span: "We want to get out of the business of helping auto companies as quickly as we can...In the same way I want to get out of the business of helping banks. But we have to make some strategic decisions about strategic industries."

Other approaches are a bit more subtle. Much of the $787 billion federal stimulus package passed in February goes to the states, but only if they comply with federal guidelines on how to spend the money. For instance, to obtain additional federal assistance for unemployment insurance, states must make more workers eligible for benefits, in particular part-time workers.

Many states have revolted against such conditions, arguing that they will saddle states and employers with added costs long after the stimulus money has run out. Republican governors in South Carolina, Alaska, Louisiana, Mississippi and Texas have made a show of refusing some of the stimulus money.

Indiana has so far turned down the unemployment-insurance money but took most of the rest, although not enthusiastically. Mr Kenley flips through a thick wad of paper on his desk. It contains the federal guidelines a state must follow to get education-stimulus money, such as ensuring that poor and minority children are not taught disproportionately by unqualified teachers. Federal money to weatherproof poor families' homes must be channelled primarily through non-profit groups. It is the micromanagement that Mr Kenley objects to, not the goals: "They're going to control your behaviour with specifications and regulations. It's a tough pill to swallow, but we have to take the money and do the best we can."

Governor Daniels, who was a budget director under Mr Bush and has impeccable conservative credentials, has a more nuanced view. "People in a time of difficulty and apprehension are looking for energy, for active government, but that doesn't necessarily mean statist government. People...are still suspicious, though maybe a little less so, of government."

Reuters


**The angry ones**

Accordingly, in 2007 Mr Daniels raised cigarette taxes to pay for health insurance for poor families who could not afford to have it. Mr Kenley opposed him, arguing that it would be more appropriate to encourage people, through the tax system, to provide for their own care. Mr Daniels's response was: "You need to do this or you'll end up with single payer [the single scheme that the protesters in Indianapolis were calling for]." He argues that reducing the number of uninsured by discouraging smoking does not conflict with Republican principles: "If it's not conservative enough for some, that's one of my rare heresies."

Robert Stone, an affable, bearded emergency-room doctor who organised last week's demonstration in Indianapolis, says it is encouraging that a conservative governor like Mr Daniels is willing to raise taxes to pay for expanded health care. But not, he goes on to say, if this is just a substitute for universal access.

Mr Stone has run up small victories in the past year. In January the city council of New Albany, in the conservative southern part of the state, passed a resolution supporting a single-payer health plan. But Mr Stone has been unable to persuade many of the state's senior Democratic politicians to endorse the idea.

Baron Hill, a Democratic congressman who represents the southern part of the state, has sounded sympathetic, and has even invited Mr Stone to address the Blue Dogs caucus of fiscally conservative Democratic congressmen. But, to Mr Stone's frustration, he has yet to set a date. Government-run health care is still anathema to many Americans. Mr Stone received a reminder of that the day before the rally; a vitriolic letter decrying "so many socialist if not communist [sic] working against the best social economic and progressive system in the world, capitalism."

## Can he get away with it?

Mr Obama, too, is aware of the emotional opposition that government ownership can elicit. He once advocated a single-payer system, but has since said that would make sense only if starting from scratch; now, he vows to work within the current system of employer-based health care. He has advocated a public plan similar to the federally funded Medicare plan (which is only for retirees) to compete with private plans, but even that is open to negotiation.

That scaled back goal, like many of Mr Obama's ambitions, faces a daunting obstacle: money. The economy has turned out weaker than the president expected, depriving him of hoped-for tax revenue. Congress is inclined to give away rather than sell permits to emit carbon dioxide in its cap-and-trade programme. Meanwhile, polls show high anxiety among voters about record deficits and rising debt.

Such fiscal constraints, however, do not apply to new regulations. The costs will be difficult to identify, notes Robert Litan, a scholar at the Kauffman Foundation, a think-tank. Mr Obama, for example, has said his administration will be less inclined than its predecessor to invoke federal rules to shield companies from state consumer-protection laws. That means companies face a higher risk of product-liability suits, which could discourage innovation and restrain growth.

The public, however, will not see those costs, and thus probably will not care. "The public is not in a discriminating mood when it comes to regulation," says Mr Litan. "If it addresses something they're angry about, like executive compensation, fine. As for everything else, the public wants more certainty and less anxiety in their lives." In a few years, the question will be: "Did Obama move us out of the cellar? If the answer is yes, they won't care about the details."

**Barack Obama's Supreme Court choice**

# Scrutinising Sonia

May 28th 2009 | WASHINGTON, DC
From The Economist print edition

**Conservatives are furious, but she will be confirmed anyway**

THE attack ads were up and clickable even before Barack Obama's announcement, on May 26th, that he would appoint Sonia Sotomayor to the Supreme Court. Ms Sotomayor "didn't give a fair shake in court to firefighters deprived [of] promotion on account of [their] race", cried the Judicial Confirmation Network, a conservative group. "Every American understands the sacrifices firefighters make, but in Sotomayor's court, the content of your character is not as important as the colour of your skin."

The ad refers to *Ricci v DeStefano*, a case involving firefighters in New Haven, Connecticut. The city told firefighters who wanted to be promoted that they had to sit a test. But when no black firefighters passed, the city ignored the results and promoted no one. Several white firefighters and one Latino sued for racial discrimination. One, who is dyslexic, had paid to have audio recordings made of his study materials and had spent several hours a day revising for the test.

Ms Sotomayor ruled against them. She argued that although the city acted out of concern about race, its decision was "facially race-neutral". To her critics, that argument makes no sense. But America's racial jurisprudence is rather muddled. The city would surely have been sued whatever it did. The case is now before the Supreme Court.

AP

The coming argument about Ms Sotomayor will be riven with identity politics. Mr Obama's feminist supporters have been urging him to pick a woman to replace David Souter, the Supreme Court justice who recently announced his retirement. They are unhappy that only one of the nine incumbents is female. Many Hispanics, meanwhile, are keen to see the first Hispanic on the nation's highest court. Ms Sotomayor ticks both boxes.

Introducing Ms Sotomayor to the nation, Mr Obama applauded her intellect and her broad legal experience. She has been an appeals-court judge for 11 years. She has also served as a prosecutor and a corporate litigator. And unlike any of the current justices, except the man she is replacing, she has served as a trial judge, presiding over some 450 cases.

But Mr Obama made it clear that her personal background matters at least as much to him. Her parents were from Puerto Rico. She grew up in a tough part of the South Bronx. Her mother was a nurse. Her father, a factory worker, died when she was nine. As a child, she was diagnosed with diabetes and told it would scupper her dream of becoming a detective. But she studied hard, came top of her class at Princeton and edited the *Yale Law Journal*.

Americans are impressed by her biography. But some are perturbed by her apparent belief that her sex and ethnicity will make her a better judge. "Justice [Sandra Day] O'Connor [is said to have said] that a wise old man and a wise old woman will reach the same conclusion in deciding cases. [I am] not so sure that I agree," she told a Californian audience a few years ago. "I would hope that a wise Latina woman with the richness of her experiences would more often than not reach a better conclusion than a white male who hasn't lived that life."

Conservatives argue that race and sex should be irrelevant when promoting judges—or firefighters, for that matter. They also think judges should apply the law impartially. Ms Sotomayor seems hazy on this

point. In that speech in California, she said she agreed “that judges must transcend their personal sympathies and prejudices”, but added: “I wonder whether achieving that goal is possible in all or even in most cases. And I wonder whether by ignoring our differences as women or men of colour we do a disservice both to the law and to society.”

## Stirring things up

To pre-empt another line of criticism, Mr Obama assured Americans that Ms Sotomayor “understands that a judge’s job is to interpret, not make, law”. Conservatives believe that elected politicians should make laws and judges should apply them, or throw them out if they violate the constitution. They fear that Ms Sotomayor takes a more expansive view of judicial authority. She once said that the appeals courts are where “policy is made”; though she immediately backtracked, perhaps mindful that she was being filmed. On another occasion, however, she said that “the duty of a judge is to follow the law, not to question its plain terms.”

Some observers think Ms Sotomayor will make little difference to the Court, since she is a liberal replacing another liberal. Not so. At 54, she is 15 years younger than Mr Souter, and Supreme Court appointments are for life. And Mr Souter was no stereotypical liberal. He tended to side with the court’s liberals on social issues such as abortion. But he took a conservative view of frivolous lawsuits against corporations and excessive punitive damages.

How Ms Sotomayor will shape the court is hard to discern. In cases where plaintiffs allege discrimination because of race, sex, disability or age, she has usually sided with the plaintiffs. But she once ruled that the right to free speech barred New York City from firing an office worker for posting a racist letter.

She has never ruled on gay marriage, an issue likely to come before the Supreme Court before long. Her views on the death penalty or executive power are unknown. She once ruled against an abortion-rights group, but the case turned on whether the government can attach strings (specifically: don’t promote abortion) to money it gives to foreign charities. She said it can, which was hardly controversial.

Her decisions as an appeals-court judge will be minutely examined in the coming weeks. Gun-rights absolutists are up in arms, so to speak, about her view that the second amendment does not apply to the states. (In *Maloney v Cuomo*, she ruled that New York could ban a martial-arts weapon consisting of two sticks linked with a chain.) Property-rights enthusiasts shudder at her ruling, in *Didden v Village of Port Chester*, that the government could seize a man’s land so that a developer could build on it, even though both parties wanted to build the same thing—a pharmacy. Economists sigh that she ordered the Environmental Protection Agency not to weigh costs against benefits in enforcing certain provisions of the Clean Water Act.

Yet for all the heat Ms Sotomayor’s nomination is generating, she will almost certainly be confirmed by the Senate. She may be left-of-centre, but that is what people expect from a Democratic president. Nothing in her record is wildly out of the mainstream. And Democrats have an ample majority—at least 59 seats out of 100.

Republicans, meanwhile, are treading softly. They are traditionally easier on the other party’s judicial nominees than Democrats are. Bill Clinton’s two nominees were confirmed by 96 votes to three and 87 to nine respectively. Some Republicans say their party should copy the tactics of the Democrats, who launched aggressive and personal attacks on conservative nominees such as Samuel Alito, Clarence Thomas and Robert Bork. But cooler heads retort that this would backfire: Ms Sotomayor will be confirmed anyway, and yet more Hispanic and female voters will desert the Republican Party.

Barring some unforeseen scandal—and one assumes she has been carefully vetted—Ms Sotomayor will join the Court in time for its next session. As an appeals-court judge, she was always obliged to defer to precedents set by the Supreme Court. Once on the Supreme Court she will be free to rule as she pleases, for two, three or even four decades to come.

**The Guantánamo row**

# Cross purposes

May 28th 2009
From The Economist print edition

**Everyone wants a plan. But it is easier promised than done**

INEXPERIENCED new presidents can get their timing wrong. Months before the September 11th attacks and the "war on terror", some of George Bush's officials quickly regretted withdrawing America's support for the Kyoto protocol on climate change without offering a constructive alternative, for it put backs up needlessly the world over. Barack Obama's failure to present a detailed plan to deal with the remaining 241 detainees at the Guantánamo Bay detention centre, which he has promised to close by January 2010, has likewise helped to spark a bitter row.

Mr Obama is being attacked from both right and left. And all the shouting in Washington makes it harder for other governments, especially in Europe, to help America out of its predicament by taking Guantánamo inmates off its hands. Fifty or more are expected soon to be cleared for release who cannot be returned to their home countries for fear of ill-treatment.

It would help if Mr Obama could give a lead by showing that America was ready to resettle some of these people in its own communities. That is proving hard. Although most Americans think terrorist suspects who are found to be innocent by the courts should be released (see table), few places seem ready to accept them. Hectic posts on the internet raise the prospect of wild-eyed jihadists in everyone's back yard. And at least one bill now in Congress would tie funds for closing Guantánamo to a determination that none of its inmates could settle in America once freed.

Northern Virginia's small Uighur community may be first to buck this trend, offering homes to up to seven of a group of 17 Chinese Uighurs already set for release but with nowhere to go. That could help Germany accept an informal request from the Obama administration to take nine more of the same group. Most Uighurs are considered more anti-Chinese than anti-Western, and China will be livid wherever they go. (Mr Bush had earlier persuaded Albania to take in a handful, though by all accounts those that went are far from happy there.)

Elsewhere in Europe, Britain and France have already taken back other men released from detention, not all of them either nationals or residents, and both have said they would at least consider taking more. Austria, the Czech Republic and the Netherlands have flatly refused. But even in countries where foreign ministers want to be co-operative, justice and interior ministers are often wary. They will have noted recently released Pentagon figures showing that 14% of the more than 530 Guantánamo prisoners released under the Bush administration (mostly to Arab countries) have resumed militant activities.

Meanwhile, the outlines of Mr Obama's missing plan are becoming clearer. Critics to his left were heartened to know that some terrorism suspects will be tried on criminal charges in ordinary federal courts. But Mr Obama also intends to revive military commissions for others. He voted against them before, but they will be properly constituted this time, he says, and with more extensive rights for defendants. Last week he acknowledged that the "toughest decision" would be to devise a system of detention to replace Guantánamo, though one properly supervised, he said, by Congress and the courts, for those—including senior al-Qaeda men—who cannot be prosecuted but who pose a clear danger to

***The Economist*/YouGov poll**

%

| | |
|---|---|
| ***Do you think the US should continue to operate Guantánamo Bay prison or close it down?*** | |
| Continue to operate | 49.6 |
| Close down | 30.6 |
| Not sure | 19.8 |
| ***Do you favour or oppose holding trials for the terrorist suspects being held at Guantánamo?*** | |
| Favour holding trials | 61.9 |
| Oppose holding trials | 21.9 |
| Not sure | 16.2 |
| ***If trials are held for terrorist suspects, should they be held in US courts or military tribunals?*** | |
| US courts | 20.6 |
| Military tribunals | 61.4 |
| Not sure | 18.0 |
| ***If a terrorist suspect is tried and found innocent, should he be released?*** | |
| Should be released | 64.3 |
| Should continue to be held indefinitely | 14.7 |
| Not sure | 21.0 |
| ***Would closing Guantánamo Bay prison improve or damage America's standing in the world?*** | |
| Improve | 30.0 |
| No effect | 28.5 |
| Damage | 16.7 |
| Not sure | 24.8 |

Source: *The Economist*/YouGov poll, May 24th-26th 2009

America.

That is unlikely to assuage the president's critics on the right. Dick Cheney, Mr Bush's vice-president, has lambasted Mr Obama for releasing confidential memos (later countermanded) from the Bush years detailing harsh treatment that was allowed to be used on three "high-value" Guantánamo detainees. Even some of Mr Obama's own senior officials were uneasy about their publication. This is a row that will run and run.

Cities and their deficits

# Staring into the abyss

May 28th 2009 | CHICAGO AND PITTSBURGH
From The Economist print edition

**Lay off 4,000 workers, or let the mayor cut the grass?**

Getty Images

CHICAGO'S skyline may be glorious (see above), but the city's big shoulders are slumped. In November the city passed a budget to close a $469m shortfall. But in the first four months of 2009 a gap opened again, of $96m. By the end of the year, the city expects it to be about $300m.

A recent report by the Philadelphia Research Initiative, an arm of the Pew Charitable Trust, looks at how 13 cities are dealing with budget problems. All but one have deficits, thanks to the fall in property taxes, the dramatic drop in consumer spending, high unemployment and the subsequent decrease in income tax revenues. Budgeting, usually a headache endured annually, has become a chronic migraine for many city governments. Even pessimistic revenue projections have had to be revised.

Most cities are cutting services. Hiring freezes are the norm. Employee-related costs—payroll, pensions and health benefits—make up the largest part of any city budget, generally 60-75% (and more than 80% of Chicago's). Richard Daley, Chicago's mayor, recently proposed that the city's 3,600 non-unionised workers should take 16 days of unpaid holiday by December 31st. New York City is preparing to cut 3,800 municipal jobs. Atlanta, meanwhile, is imposing a 36-hour work week for almost all its city workers, including the police. This has saved "the Big Peach" $11.5m.

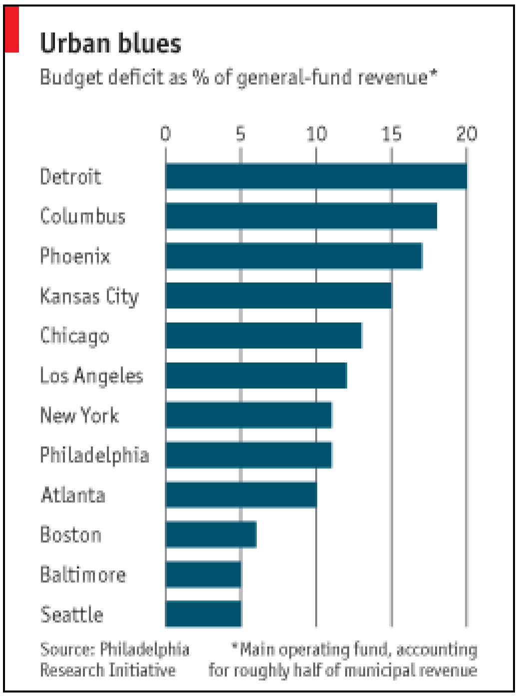
In Chicago Mr Daley wants unionised employees, who comprise 90% of all city workers, to make concessions as well. The unions, unsurprisingly, are refusing to budge. They want a guarantee that if they comply with Mr Daley's demands now, they will not face layoffs as Chicago's revenues continue their downward slide. Antonio Villaraigosa, Los Angeles's mayor, is seeking 1,200 city worker layoffs and 26 furlough days to close his $529m deficit. Up to 2,800 could be fired unless the unions make concessions. Boston has had better luck with its unions, who have recently given up pay rises or deferred them.

Union concessions are also needed to reduce pension and health costs. These will be even trickier to negotiate. Underfunded pension plans are a growing worry for many cities. Philadelphia wants new recruits to contribute more to their pensions. Kansas City hopes to reduce health costs though increased employee contributions.

The Pew report also looked at how cities are generating revenue. Many of them, like Boston, do not have the authority to raise taxes and must rely on state funding. New York City requires state approval to levy sales taxes, while a public vote is needed in Columbus, Ohio. Even where cities have some flexibility, argues Michael Pagano of the University of Illinois at Chicago, they cannot tap important engines of growth, hospitals and universities, because these are tax-exempt. Chris Briem, an economist at the University of Pittsburgh, thinks a commuter tax would help offset costs. As he points out (and as many mayors have long argued), suburban commuters still use the city police and drive on city streets.

Fees may be an easier option. New York's mayor, Michael Bloomberg, wants to impose a five-cent fee on plastic bags. Seattle has raised fees for rubbish collection. Several cities are

considering leasing municipal assets. Chicago has raised $3.5 billion since 2005 by leasing a tollway, garages and parking meters. Credit for such deals, however, is drying up.




All in all, the future looks grim. Even if the economy recovers tomorrow, there is generally an 18-24-month lag before cities feel it. Many will be in worse shape in 2010 and 2011, according to the National League of Cities, a lobby group. But most are plugging present holes with little thought for the morrow.

The one bright spot in the Pew report, surprisingly, is Pittsburgh. The city and its region, once synonymous with steel, lost 120,000 manufacturing jobs in the 1980s. But over three decades it diversified. Now its main industries, health care and education, are thriving. The waterfront, once lined with factories, has been transformed into parks. Bethlehem Steel's former home is now the site for a casino resort. Pittsburgh narrowly avoided bankruptcy in 2003, and was forced into state receivership. But it actually has a surplus now.

Pittsburgh is in relatively good shape because it largely missed the housing and dotcom booms enjoyed by the rest of the county. Indeed, it is currently building a new sports arena and a new hospital. Because of its 2003 brush with bankruptcy, it cut its city workforce by a quarter, implemented a salary freeze and made many hard decisions, such as closing fire stations. The other cities in Pew's report could learn a few lessons from Pittsburgh.

When all else fails, there is still civic pride to fall back on. Some cities are appealing to their citizens—to help at a youth centre, for example, when its budget has been cut. The mayor of Toledo, Ohio, is going one step further. He is personally mowing a city park's grass.

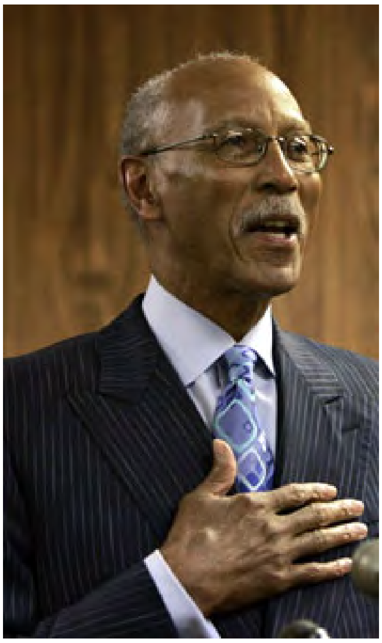
**Detroit's new mayor**

# Baptism by five-alarm fire

May 28th 2009 | DETROIT
From The Economist print edition

**An ex-basketball player tries to get to grips**

AP


Can Bing bring in change?

WHEN Detroit's new mayor took the stage at a recent breakfast forum, the audience left their eggs and bacon to give him a standing ovation. "You've got nowhere to go but down from here," the forum's moderator said dryly.

Dave Bing played basketball for the Detroit Pistons before becoming a respected businessman. On May 5th he won one of the worst jobs in American politics. Detroit's budget must be approved on June 2nd. The tasks that follow are even more daunting.

The city is familiar with misery. For decades it has endured industrial decline and strained relations with its suburbs. But the past year has been especially dismal. In September Kwame Kilpatrick, then the mayor, pleaded guilty to obstruction of justice. His interim successor, Ken Cockrel, struggled to keep the city on course. Detroit's deficit amounts to roughly 20% of its general fund. Its schools are in such disarray that Michigan's governor has sent an outsider to take charge. And General Motors, a main employer, whose logo crowns Detroit's tallest tower, will probably declare bankruptcy by June 1st.

Top of Mr Bing's agenda is plugging the deficit. Mr Cockrel's budget proposal, crafted in April, includes firing more than 300 workers and trimming wages. Mr Bing will probably approve these plans, but finagling will continue.

Mr Bing must also revive a deal to expand ageing Cobo Hall, home of the North American International Auto Show. A plan to give control of Cobo to a regional authority stirred the old fight between city and suburbs. Talks imploded in February, with city councillors arguing that Detroit would give up a prized asset and local jobs for little in return (though the suburbs would help pay for the expansion). Car-show executives say they will consider other sites for 2011 unless a deal is passed.

If Mr Bing survives this baptism by five-alarm fire, fundamental questions remain. For years reinvention has been the stuff of much talk and little progress. Doug Rothwell of Detroit Renaissance, a group of executives, says Detroit must do far more to lure skilled workers and foster regional co-operation. The city's management must also change dramatically. Detroit's population has shrunk by half since 1950, but more than 40 departments serve a city big enough to cover San Francisco, Boston and Manhattan combined, says Dan Pitera of the University of Detroit Mercy. On the city's east side buildings stand in various stages of decay, some boarded up, some burned, some with rotting walls that seem to melt slowly in the sun.

Momentum for action, however, is building up. On May 18th the New Economy Initiative (NEI), funded by ten foundations, announced grants to spur entrepreneurship and help car-suppliers diversify. The effort, explains Dave Egner of NEI, will help attract and nurture human capital. Mr Pitera has ideas for how Detroit might use its swathes of abandoned land, whether for farms or artists, theatres or wind projects. Mr Cockrel, now a valuable force in the City Council, advocates what he calls "creative downsizing".

With the demise of the Big Three, a simple fact may sink in at last: Detroit will not be what it was. Mr Bing is hardly a force of nature, but he has the benefit of business sense, a life outside Detroit's divisive politics and apparently no hopes for higher office. This disaster begs a bold response. He may yet provide it.

Gourmandise in New England

# The baguettes can stay

May 28th 2009 | COLEBROOK, NEW HAMPSHIRE
From The Economist print edition

**A tiny bakery provokes an international incident**

THE recession has been particularly brutal in Colebrook, in forested northern New Hampshire. Paper-milling is now a dead industry there. The Ethan Allen furniture factory, just across the state line in Vermont, has laid off more than 100 workers since February. The local Ford dealership has closed, and so has downtown's main restaurant. Even The Balsams, a nearby grand hotel and a big employer in "The Great North Woods", has trimmed staff as visitors have dwindled. "Our economy is really terrible. There are no jobs," says Donna Caron, the town manager. "We can't take much more."

And then a bureaucratic decision made thousands of miles away—in the American embassy in Paris, in fact—threatened to close down Colebrook's much-loved French bakery. The owner-operators of Le Rendez-Vous, Verlaine Daeron and her partner Marc Oulic, are both French citizens; but when Ms Daeron applied to the embassy last year for an extension to her E2 visa, the State Department said her business did not bring enough economic impact to Colebrook to allow her to stay.

Her customers believed otherwise. "It's a little bit of Paris in a town where hardly anyone has been to Paris, and the aromas are to die for. When you walk through the door you are in a different world," swoons Ms Caron. Le Rendez-Vous is also a community centre, hosting concerts and performances, and, like *boulangeries* everywhere in France, it is Colebrook's main stop for local gossip in addition to fresh bread. When Ms Daeron returned to Paris earlier this year, she carried two pounds of letters written in support of the business and a petition signed by dozens of Colebrook residents. At the embassy "they said they had never seen such a thing".

Those embassy officials might have wondered what a French bakery was doing in Colebrook, which is better known for snowmobiling, fishing and hunting rather than *boules* and baguettes. But a chance meeting, while on holiday, with a French-speaking member of the Colebrook Chamber of Commerce persuaded Ms Daeron to take ownership of an old bank building downtown, and to spend a year remodelling it into Le Rendez-Vous.

Last week the embassy approved an extension to her visa. She is already planning her baking schedule to cover all the extra baguettes needed for Colebrook's moose festival in August.

**Lexington**

# Tough enough?

May 28th 2009
From The Economist print edition

**Barack Obama must pass the telephone test**

Illustration by KAL

FIFTEEN months ago, at the height of the battle for the Democratic nomination, Hillary Clinton unleashed her most powerful weapon, a telephone call. “It’s 3am and your children are safe and asleep,” a voice intoned. “But there’s a phone in the White House and it’s ringing. Something is happening in the world.” Barack Obama might be able to give a pretty speech. But was he “tested and ready to lead in a dangerous world”?

The telephone has been ringing off the hook of late, as hostile governments tweak the new administration, to see what it is made of, and Republican politicians raise doubts about Mr Obama’s national-defence credentials. On Memorial Day North Korea tested a nuclear bomb, following up with a few ballistic missiles for good measure. (The North Koreans were kind enough to give the administration a heads-up, in case the Mr Magoos of the intelligence establishment missed the fireworks.) On May 21st Dick Cheney delivered a televised speech accusing the administration of unravelling “some of the very policies that have kept our people safe since 9/11”. The day before that, the Iranians tested long-range missiles.

All this has put Mrs Clinton’s question from last February back at the heart of American politics. Conservative websites are buzzing with comparisons between Mr Obama and Jimmy Carter. “Jimmy Carter took a little over three years to create the image of the US as a confused and soft power,” argues Bahukutumbi Raman on Forbes.com. “Obama is bidding fair to create that image even in his first year in office.” Some Democrats are also whispering that they are worried about the comparison. Mr Carter’s weakness on foreign policy locked the Democratic Party out of the White House for over a decade. Mr Obama needs to prove that he is capable of doing the “daddy things” (defending the country) as well as the “mommy things” (appointing empathetic Supreme Court justices).

How much truth is there that Mr Obama is flunking the telephone test? The problem with North Korea is that it is not a fair test of anything. It is easy to mock the finger-wagging from Susan Rice, Mr Obama’s ambassador to the United Nations, about violations of international law, as the perfect example of pusillanimous liberalism.

But where would “toughness” get America? It would be hard to make the Hermit Kingdom any more isolated than it already is. Cutting off American aid would produce mass starvation without depriving the

ruling elite of its luxuries. It might also risk destabilising a country that has many thousands of artillery pieces and rockets aimed at Seoul. George Bush tried toughness, including branding North Korea a member of the “axis of evil”, before returning to softer policies.

Mr Cheney’s critique of Mr Obama’s naiveté is a much fairer test than Kim Jong Il’s fireworks. But in fact Mr Obama passes the Cheney test fairly well, providing a well-calibrated combination of toughness and strategic innovation. He may have made a lot of noise about talking to America’s enemies. He may have abandoned Bush-era phrases such as “the war on terror”. But he has done little to unwind that war.

He has embraced Mr Bush’s policy of gradually withdrawing combat troops from Iraq. He has increased the number of troops in Afghanistan by around 20,000. He has also stepped up drone attacks on what the American army calls the “Af-Pak” region. Far from abandoning the war on terror, Mr Obama is shifting its central front from Iraq to Afghanistan, and doing what he can to sell it better. That hardly counts as naive doveishness.

Mr Cheney concentrated his heaviest rhetorical fire on Mr Obama’s opposition to “enhanced interrogation”. But such opposition is hardly a sign of wimpishness. Large numbers of military and former military officers, including David Petraeus, the head of Central Command, and John McCain, a man who was brutally tortured by the North Vietnamese, have come out strongly against practices such as waterboarding, for both practical and moral reasons. The information that such techniques produce is often tainted, and the damage that they do to America’s image around the world is immense.

## Living with Mr Kim

Still, it would be wrong to imply that Mr Obama has passed the telephone test with flying colours. The president is paying the price for raising expectations about the power of diplomacy to absurd heights. So far Mr Obama’s charm offensive has produced plenty of warm words but few practical concessions. The Europeans have refused to stimulate their economies as much as America would like, or to send a significant number of troops to Afghanistan. Iran has become even noisier about its desire to go on enriching uranium. Mr Obama is now finding out, as the Bush administration did before him, that some regimes are not susceptible to American policies, hard or soft, wise or dumb.

Mr Obama is also guilty of doing too little to prepare for life with North Korea. The administration has paid remarkably little attention to the country. Mr Obama’s special representative for North Korean policy has retained his job as a university administrator. The top East Asia specialist at the State Department has still not been confirmed, though that has more to do with the Senate’s sloth than with Mr Obama’s negligence.

The administration has pulled off a short-term coup by shifting public attention from North Korea to the Supreme Court, at least for a while. But Mr Kim and his kind will not disappear. Mr Obama needs to fill the gaps in his administration as quickly as possible. He also needs to lower expectations about what can be achieved by replacing one American president with another. The 3am call is still the one that can make or break a presidency.

Canada's relations with the United States

# Stop, border ahead

May 28th 2009 | OTTAWA
From The Economist print edition

**New border controls and protectionist bills have dashed Canadians' hopes that the change of occupant in the White House would mean warmer relations**

Christinne Muschi


WHENEVER Canadians grow anxious about heightened security at the United States border—as they are now because of America's new requirement, from June 1st, for passports or other approved identification to be shown at entry points—their news media invariably invoke the twin towns of Stanstead, Quebec, and Derby Line, Vermont. In these towns, the line that looks so neat on maps is a messy business, running through a factory, a combined library and opera house, and a number of homes. In some cases it lies between the bedroom and a morning cup of tea.

To Canadians, this pleasing informality underscores their special relationship with Americans, with whom they share the world's closest country-to-country trade ties as well as bonds of kinship. Until September 11th 2001 Americans and Canadians crossing the border often only needed to state their nationality. Even after the attacks a wide range of informal identification documents was accepted.

Such laxity is an anomaly to Janet Napolitano, President Barack Obama's homeland-security secretary, who wants controls along the United States' northern border to be brought closer in line with those on the frontier with Mexico. Speaking to reporters before a two-day visit to Canada, on May 26th and 27th, Ms Napolitano said she wanted to "change the culture" along the 8,900km (5,500-mile) line to make it clear that "this is a real border."

Her words are a clear sign that the Obama administration will not only uphold but enhance measures introduced since 2001, despite complaints from both sides of the border that they impede movements of all sorts, particularly trade in goods that was worth $1.6 billion a day in 2008. Ms Napolitano tried to assuage Canadian concerns during her visit, talking of the need to help trade, jobs and growth. But her department's plans to install heat-detecting sensors along the border, put more surveillance drones in the sky and place additional cameras along the St Clair river in Michigan and the Upper Niagara in New York are taken by some frontier communities as a personal affront.

American officials say the millions of new identity documents they have issued should ensure that there will be no big delays at the border after June 1st. But if their confidence is misplaced, heaping more trouble on Canadian exporters already struggling to cope with the recession, the bilateral relationship is likely to sour.

Some Canadians understand that their southern neighbour has real concerns about security, given the relative openness of its northern border. “We’re not going to go back, no matter how much we want to, to the situation before 9/11,” says Shirley-Ann George, head of policy at the Canadian Chamber of Commerce. “But we can make it better.” The chamber has been working with its American counterpart to propose ways of reducing border delays while maintaining adequate security. These include clearing shipments and people before they get to crossing-points.

Canadians are already worried at signs of rising protectionism in their neighbour’s Democrat-led Congress, in the form of Buy American provisions in the economic-stimulus package and proposals in a new environmental bill to impose trade sanctions on countries with high levels of greenhouse-gas emissions. Their indignation has been heightened by two unfortunate incidents. A contractor at the Camp Pendleton Marine base in California ripped out a section of sewerage pipe because it was Canadian-made; and a Canadian salesman travelling to an equestrian-products trade show was turned back at the Washington state border on the ground that he was “stealing” American jobs.

Tony Clement, Canada’s industry minister, says all this risks provoking a backlash among his countrymen. It has already begun. The industry group representing Canadian manufacturers has identified seven bills with protectionist provisions making their way through Capitol Hill and is calling for Canada to threaten retaliatory action. On May 25th a member of Canada’s left-leaning New Democratic Party introduced a private member’s bill that would require the government to give Canadian companies priority when buying goods or services.

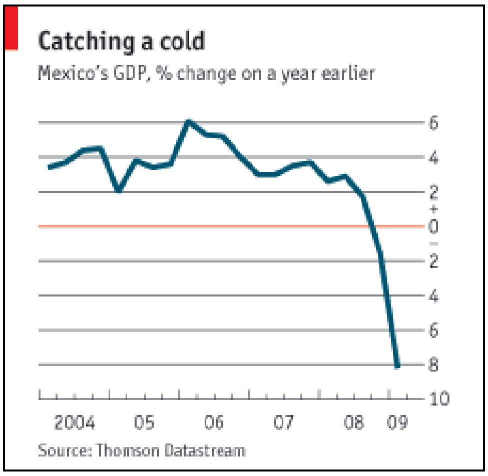
Like many others, Canadians had unrealistic expectations of how much things would change when Barack Obama replaced George Bush. Ms Napolitano’s words both before and during her visit to Canada have put an end to such optimism. For the new occupant of the White House, as for his predecessor, the noisy demands of Capitol Hill will always drown out any whimpers from across the border.

**Mexico's deep recession**

# Not made here

May 28th 2009 | MEXICO CITY
From The Economist print edition

**It is little consolation to Mexicans that the slump is not their fault this time**




AFTER suffering unprecedented drug-related violence and the swine-flu outbreak, Mexicans must feel they have already had a year's worth of bad news. Yet on May 20th they were hit by another blow: the government said that the economy had shrunk by 5.9%, seasonally adjusted, in the first quarter of 2009, four times the predicted fall in Latin America as a whole. The grim figure leaves no doubt that serious pain awaits in the form of increased poverty and unemployment.

Unlike many past economic crises, the latest one does not bear a "made in Mexico" label. Instead, it is the nation's close integration with the United States that has left it worse off than its Latin American peers. Exports across the Rio Grande are equivalent to a fifth of Mexico's GDP, and have fallen by 36% in the past year as demand on the other side has collapsed.

Moreover, American multinationals have frozen their foreign-investment budgets and are repatriating their Mexican offshoots' earnings to their cash-starved corporate parents, causing capital flight and a depreciation of the peso. That has starved the country's relatively shallow financial system of liquidity, which in turn has choked off consumer credit. Remittances from migrant workers in America have also declined. "This global crisis seems especially designed to hurt Mexico," laments Raúl Feliz of CIDE, a think-tank.

The second quarter is unlikely to provide much comfort. Authorities virtually shut down Mexico City for a week at the end of April to control the flu outbreak. Even now that the virus has been shown to be less dangerous than feared, the negative publicity it generated has cast a pall over the country's tourism industry, which is its third-biggest source of foreign exchange and employs 2m people. The government expects tourism revenues to drop by up to 30% this year.

The unemployment rate has risen from 3.6% to 5.3% over the past year. And for every two Mexicans without a job, there are three who are underemployed. These figures will rise further as job opportunities in the United States dry up. Since Mexico lacks unemployment insurance, the ranks of its poor are thus expected to swell. Although the government does provide welfare payments, adding huge numbers of new recipients to the rolls will take time.

The conservative administration of President Felipe Calderón announced fiscal-stimulus measures last year in anticipation of the recession. But those outlays now seem modest given the magnitude of the crisis. And unlike the governments of richer countries, Mexico's has little freedom to borrow-and-spend its way out of recession. Although its debt load is a mere one-third of GDP, less than half the OECD average, its weak capacity to generate revenue spooks bondholders. Federal taxes are worth less than 10% of GDP, with volatile oil revenues accounting for about another 5%—and those proceeds are expected to fall dramatically in 2010, after the state energy company's contracts to hedge its output at above-market prices expire.

With the government's options limited, Mexico's economic destiny is more or less in the hands of its northern neighbour. Although that has been a curse so far, many economists say it may soon become a blessing, since the United States is expected to begin its recovery faster than Europe or Japan. Even so, making up all the ground Mexico has lost will not be easy. According to Alejandro Villagómez of the Technological Institute of Monterrey, the economy will probably need up to four years to return to its long-term growth trend-line in the absence of big reforms. That is far too slow for Mr Calderón, who will be held to account by disgruntled voters in legislative elections in July.

**Drug gangs in Canada**

# British Columbia or Colombia?

May 28th 2009 | VANCOUVER
From The Economist print edition

**Organised crime brings fear to Vancouver's streets**

WHILE campaigning for an election on May 12th in which he was easily re-elected, Gordon Campbell, the premier of British Columbia (BC) province, had a personal brush with violent crime. As he was being interviewed by a reporter at a Vancouver hotel, a woman with a gun ran by, having robbed a jeweller. The premier's bodyguard hustled him to safety; the robber was later arrested. But the incident should have reminded Mr Campbell that crime worries voters almost as much as the recession.

Canada remains one of the world's safest countries but in recent years Vancouver, BC's largest city, has gained notoriety for gun crime, especially among drug gangs. Since 1997 nearly 450 gangsters have been killed there. The surge in shootings is “directly related” to a crackdown on gangs in Mexico and the United States, says Pat Fogarty, a senior officer in the Royal Canadian Mounted Police. Recent arrests by the three countries' police forces have disrupted a Mexican-run cocaine distribution chain, leaving Vancouver's street dealers fighting to secure their supplies. “The price goes up and the guns come out,” says Mr Fogarty.

Vancouver has become a distribution hub in a global drugs trade stretching to Asia and Europe. Local gangs ship out cannabis, amphetamines and ecstasy made in BC, importing cocaine, heroin and guns for the Canadian market. Around 135 gangs are thought to be fighting over a business worth an estimated C$7 billion ($6.2 billion) a year.

That they do so in broad daylight demonstrates the feckless response of the provincial government and police, despite reports dating back more than 30 years giving warning of the growth in organised crime. Rob Gordon, a criminologist at Simon Fraser University, says attempts at creating an agency to curb the gangs have repeatedly failed. Two such agencies have been disbanded since 1998 because of conflicts among the various participating police forces. The current effort at collaboration, led by the Mounties, is also “riven with conflict”, he says.

Despite great public concern over crime, it got little attention in the election. Mr Campbell's Liberals and the opposition New Democrats promised more police and prosecutors. But neither, says Mr Gordon, appeared to have a long-term strategy to control organised crime.

Despite some recent high-profile arrests of gangsters, Vancouver's local police admit they are not winning the war. They complain of having fewer officers per head of population than other big Canadian cities. The provincial government is planning a C$20m cut in annual spending on police and the courts by 2012. The gangsters, by contrast, are well funded and have little trouble replacing those lost in shoot-outs.

Argentina's farming in crisis

# Parched earth, empty barns

May 28th 2009 | ROSARIO
From The Economist print edition

**Don’t get mad, get organised, battered farmers conclude**

AFP

IN HIS office above an ornate trading floor where agricultural-futures contracts were first bartered a century ago, Jorge Weskamp, chairman of Rosario’s grain exchange, despairs at the state of Argentine farming. A protracted drought in the Southern Cone, reduced world prices and disastrous government policies have led to a wheat crop weighing 47% below last year’s and worth 61% less.

Argentina’s wheat-futures market vanished in March 2008 when, after a ferocious spat with the farmers, the government restricted exports. Farmers now anxiously resowing the parched pampas are expected to plant wheat over as little acreage as was sown in 1903, when pioneers were still expanding the frontier, says Mr Weskamp. If the rains treat this new crop roughly, one of the world’s natural breadbaskets may not produce enough wheat next year to meet domestic demand for only the second time since the 1870s. Yet it could supply three times that amount.

Amid 17-19% inflation, the government of President Cristina Fernández de Kirchner is trying to control the prices of some locally consumed foodstuffs by sporadically preventing their export. But agriculture earns Argentina much of its sorely needed foreign currency, so for produce that is allowed to leave the country Ms Kirchner has hiked export taxes as high as 35%. These policies will cause long-term damage to output. Farmers are scrimping on fertilisers to replenish the soils they plunder; some are leaving the land. Struggling farmers are making ends meet by selling poorly fed cattle at a loss. In 2008, for the first time, Argentina exported less beef than Uruguay, its tiny neighbour. In 18 months from now, warns a local agricultural scientist, beef exports will probably cease. “Either consumption will have to go down or we’ll have to import less tasty steak at higher cost,” he says. That prospect, abhorrent to *asado*-loving Argentines, would matter less if other parts of the economy were as productive as agriculture but few are.

To reduce their exposure to the similarly unpredictable risks from the weather and government policy, farmers are moving towards a monoculture of hardy soyabean, which is largely eaten by pigs in China and therefore less likely to suffer export controls. But instead of two harvests of different crops each year, this strategy leaves farmers with one.

Farmers’ fiery protests last year won wide public backing. This year, although things are worse still, farmers realise that urbanites are too preoccupied by the recession to be rallied in the streets bashing pots and pans in someone else’s name. Instead, farmers are organising themselves politically, using Brazil’s powerful farming union as a model. They have united behind a proposal to phase in higher income taxes to replace market-distorting export tariffs.

In congressional elections on June 28th current or former farmers may win up to ten seats, according to *La Nación*, a newspaper. The candidates are spread across political parties, reckoning this will be more effective than forming their own single-issue party. Lucio Castro of CIPPEC, a think-tank, says this sort of

co-ordinated farming lobby is “a complete novelty in Argentina”. Ms Kirchner might note that it is winning support within the traditionally pro-industry ruling Peronist party.

**Chile's coming presidential election**

# Winds of change

May 28th 2009 | SANTIAGO
From The Economist print edition

**The Concertación is disconcerted**

FOR an outgoing government, an approval rating of over 50% ought to spell another term of office. Yet a recent poll found that one in five supporters of the Concertación, Chile's centre-left governing coalition, expects it to lose December's presidential election. These fears are not groundless. For the first time since the Concertación took office in 1990, an opposition candidate—in this case, Sebastián Piñera, a wealthy businessman—leads the polls. His victory is by no means assured but, says Marta Lagos of the local office of MORI, an opinion-pollster, his "image of triumph" will be hard to surmount.

The Concertación oversaw Chile's transition to democracy after the long dictatorship of General Augusto Pinochet and has delivered stability, growth and social progress. But it has failed to promote a new generation of leaders, and the old ones have been around for too long. Senator Eduardo Frei, its nominee for December's vote, has been president before, in the 1990s. But even within the coalition he has only lukewarm support. He was "what was left" after Ricardo Lagos, Chile's president from 2000 to 2006, and José Miguel Insulza, secretary-general of the Organisation of American States, decided not to run, says a coalition politician.

Mr Frei faces an additional challenge from a young Concertación congressman, Marco Enríquez-Ominami, whose popular support is as high as 14% in some polls. Many within the coalition have warmed to him too. "They may be disciplined in insisting publicly on their support for Frei, but part of their heart is with Marco," admits one of the older generation of Concertación leaders.

Mr Enríquez-Ominami's attraction lies partly in the charisma he inherited from his father, a founder of the socialist Movement of the Revolutionary Left in the 1960s, who was shot dead in 1974 by the Pinochet regime's security forces. But it also reflects his call for openness on such touchy issues as abortion—still banned in Chile even where the mother's life is at risk—and his pragmatism on the state's role in the economy.

Mr Enríquez-Ominami's chances of becoming Chile's next president are low. But his surging popularity is making some within the coalition wonder if, facing their toughest election yet, they need a less lacklustre candidate to take on Mr Piñera.

**North Korea's nuclear test**

# On mushroom cloud two

May 28th 2009 | BEIJING, SEOUL AND TOKYO
From The Economist print edition

**Bad behaviour from a repeat offender, but will the world agree to punish him?**

Illustration by Claudio Munoz

THE news that North Korea had carried out a second underground nuclear test, on May 25th, nearly three years after what it claimed was its first, and that it created a bigger bang this time, drew swift international condemnation. The United Nations Security Council speedily condemned the nuclear effrontery. Even China, a supposed friend of the rogue regime, piled in. Unabashed, the forces of Kim Jong Il, North Korea's oddball dictator, subsequently fired off a handful of short-range missiles for good measure.

These fireworks follow the launch in April of a three-stage rocket over Japan and the Pacific. Until that point, it was still possible to argue that increasingly belligerent rhetoric from Mr Kim's regime was just his way of catching the attention of President Barack Obama's new administration. The pariah state had long said it wanted an accommodation with the United States that guaranteed its security. But engagement with the outside world now looks near the bottom of its priorities.

North Korea also says it has torn up the truce that ended the Korean war in 1953. This was provoked, it says, by South Korea's decision to join the American-led Proliferation Security Initiative, a group that aims to block shipments of weapons of mass destruction and related contraband. South Korea was reacting to Mr Kim's nuclear test; North Korea accused it of a "declaration of war". With American and South Korean troops put on a higher alert, some kind of military clash looks possible.

North Korea has also said it is restarting its plutonium reprocessing plant at Yongbyon, closed since 2007 as part of a disarmament deal negotiated with America, South Korea, Japan, China and Russia. International nuclear inspectors have been kicked out of the country. There is also concern that North Korea will resume selling nuclear technology abroad.

Earlier this month North Korea told South Korean managers at the Kaesong industrial complex, not long ago seen as a symbol of warming ties on the peninsula, that they must sign new, costlier contracts for North Korean workers, or pack up and go. The chief North Korean negotiator of closer relations between North and South, once a confidant of Mr Kim, is rumoured to have been sent to a labour camp and even shot, possibly for taking bribes.

Mr Kim has played high-stakes games before, only to return to the six-party talks aimed at getting North Korea to dismantle his programmes in return for aid and security guarantees. With what looks to have been a successful nuclear test (the previous one fizzled) the stakes have again been raised. But the

North's actions suggest it now wants to kill the six-party process.

Indeed, Mr Kim may have other things in mind. Not since the death of the divine (and now eternally president) Kim Il Sung in 1994, and the accession to power of his son, the current leader, has North Korean behaviour appeared so erratic. One assumption is that Mr Kim is locked in negotiations over the anointing of his successor. He reportedly suffered a stroke last summer and in rare appearances since has looked a shadow of his former paunchy self. The chief surprise is that the 68-year-old Dear Leader had not set the succession in train years before. One explanation may be that his offspring appear an underwhelming lot, with no great lust for power.

In April his brother-in-law, Jang Song Thaek, was appointed to the crucial National Defence Commission. It is thought he could act as regent to Mr Kim's youngest son, Kim Jong Un, still in his 20s. Of two elder sons, Kim Jong Nam was nabbed in Japan in 2001 using a false passport. And Kim Jong Chol has so far shown most interest in that other divinity, Eric Clapton, whose concerts he attended in Germany.

Kim Jong Il, it is claimed in North Korea, was born on the slopes of Korea's sacred Paekdu mountain, and a double rainbow attended his birth. But for all that, he spent decades laying the groundwork to succeed his father, and even then many months passed before it was clear that Mr Kim was truly in command. The next succession will be trickier. That may explain why the jingoistic volume is now being cranked up, to show that Mr Kim has army support for his plans. In turn, senior commanders will be enjoying nuclear prestige.

All this leaves China in a quandary. The explosion could be felt in its north-eastern Jilin province. But the government in Beijing is more worried about turbulence in North Korea and the impact this could have on stability in its own borderlands. It is therefore likely to resist calls for tough new sanctions on Mr Kim's regime.

Yet at the same time, it does not want to hear regional demands, especially from Japan, for stronger anti-missile defences or other weaponry that would undermine its military clout. American diplomats will point out to China that by putting a curb on Mr Kim they could help the United States reassure its ally, Japan, and help damp down any alarming talk of its rearming.

But the main diplomatic action has moved for now to the UN Security Council. North Korea's actions have been met with unanimous condemnation. Japan, within range of the North's missiles, is pushing hardest for punitive sanctions on top of the existing ones that have failed to bite. Indeed, sanctions agreed after Mr Kim's 2006 test were never fully implemented, after China managed to coax North Korea back into talks.

That policy has now been shown to have failed, though China still claims that negotiations provide the only solution. It has given no hint that it is prepared to punish its ally with anything more than a scolding. If so, others may take stronger action. America has in the past shown that financial sanctions on banks that deal with North Korea can cause both them and Mr Kim massive inconvenience.

As *The Economis*t went to press, the Security Council was meeting behind closed doors to discuss a possible new resolution on North Korea. It is not certain what more can be done by way of sanctions, nor how firmly these could be implemented, even if they were agreed. Meanwhile, most members of the six-party process will want to make clear to North Korea that the door remains open to it, however much it wants to slam it shut.

**Japanese politics**

# Noh debate

May 28th 2009 | TOKYO
From The Economist print edition

**A vaunted political duel elicits yawns**

THE Japanese public received a rare glimpse of parliamentary debate on May 27th, when Yukio Hatoyama, the new head of Japan's main opposition, the Democratic Party of Japan (DPJ), squared off against Taro Aso, the prime minister and head of the ruling Liberal Democratic Party (LDP). With an election to be called by September, at which the LDP is expected to lose power after 54 years of almost uninterrupted rule, this duel had been awaited eagerly. Many considered it an appetiser for an unusually engrossing Japanese election campaign. Moreover, the battle had history: Messrs Hatoyama and Aso are grandsons of two former Japanese prime ministers who were themselves bitter rivals.

Yet the leaders personified their parties' shortcomings, with Mr Aso as the haughty old pro against Mr Hatoyama, a naïve idealist. "A politics of friendship and love," is how the 62-year-old Mr Hatoyama described his political ideal. Mr Aso flashed a characteristic sneer at this, but volunteered no alternative vision.

In a negative way, the two leaders also represent the country's disaffection with politics. More than half of Japanese want neither for their next prime minister, according to an opinion poll commissioned by *Nikkei*, a newspaper. But Mr Hatoyama, whom 29% of respondents opted for, came off better than Mr Aso, whom only 16% wanted as their leader. That was a big improvement for the DPJ on the ratings of their previous leader, Ichiro Ozawa, who resigned on May 11th after a fund-raising scandal involving his main political aide. A survey conducted in April found that only 9% wished to be led by Mr Ozawa.

But the memory of his leadership still haunts the DPJ and may damage its electoral prospects. Mr Ozawa arranged for Mr Hatoyama, a loyal lieutenant, to be his successor. Upon taking the reins he returned the favour by asking Mr Ozawa to oversee the party's election strategy. So Mr Ozawa—who is said to have kept control over the DPJ's budget, personnel appointments and policy decisions—has retained a good deal of his former power even as he has sought to escape the glare of public scrutiny. For example, he has stopped calling the weekly press conferences that top party officials routinely hold.

Whether Mr Hatoyama will emerge as his own man or a puppet of Mr Ozawa is unclear. He may feel that since he does not represent the clean break that voters hoped for, he should promulgate a more reformist agenda than his predecessor did. Meanwhile he may spend much energy holding his party together; a jumble of former leftist politicians, bankers and bureaucrats, it is sorely divided.

AP

**Hatoyama's hand of friendship**

If neither party wins a decent majority in the election, there may be more of this complexity, with both looking to bolster themselves with support from smaller parties—or breakaway factions of each other. The man Mr Hatoyama beat to lead the DPJ (but who is preferred by voters), Katsuya Okada, is already scouring Japan's smaller parties for potential allies.

The LDP is also readying for battle. It recently issued its parliamentarians with a three-volume manual on such matters as "using manners to win people's hearts", which urges members to practise smiling in front of a mirror each day. If its advice can help Mr Aso refrain from sniggering during future debates, it would be welcome, with leaders of both parties hoping to see these take place twice a month. Regular debates would represent a refreshing change in Japanese politics. If they were to involve discussion of serious issues, so much the better; but on past form that is sadly a lot to hope for.

## Pakistan's borderland war

# Swatting militants

May 28th 2009 | BANAI BABA ZIARAT
From The Economist print edition

**A mass exodus as the Pakistani army presses into the Swat Valley**

Reuters

SURVEYING the snowy peaks of Swat, Major-General Sajjad Ghani says he wants to eliminate the “Taliban savages”. His vantage, an airy ridge known as Banai Baba Ziarat, was captured by Pakistan’s army last week, after an uphill battle. The general reckons that clearing the militants from Swat, the main theatre of an army offensive launched early this month, may take three months. But with public support for the campaign, he says, the army’s morale is high; and the Taliban are in retreat.

The army claims to have killed 1,190 of an estimated 4,000 to 5,000 Taliban militants in Swat, for the loss of 75 soldiers. Most analysts suppose its losses are higher. And there are no reliable figures for civilian casualties, though hundreds are reported to have been killed or injured in crossfire. According to the UN’s estimate, some 2.4m have fled Swat and neighbouring regions to other parts of North-West Frontier Province (NWFP). Around 200,000 are in government camps, but most are depending on the hospitality of strangers. To assist them, the UN is appealing for $600m; several friends of Pakistan, including America, have already promised $224m. But as summer temperatures rise in northern Pakistan, Human Rights Watch foresees a “humanitarian catastrophe”.

The prospect of this upheaval had until recently, the army claimed, deterred it from trying to drive the Taliban from Swat. After ending a brutal four-month campaign there in February, in which many civilians are alleged to have been killed by army shelling, it made the latest of several ceasefire pacts with the militants. Under the terms of this, they were to lay down their arms; in return the government was to introduce Islamic law in NWFP’s Malakand division, which includes Swat. But the deal, which was popular in Pakistan, went bad. Instead of disarming, last month the Taliban marched into two neighbouring districts, Buner and Dir. This drew a furious response from America, with Hillary Clinton, the secretary of state, speculating on the possibility of the militants taking over Pakistan. During a visit to Washington last month by President Asif Zardari, the army proceeded to launch what has been described as its most concerted attack on the militants in a seven-year campaign. Pakistan’s prime minister, Yusuf Raza Gilani, also vows to crush the Taliban utterly. On his lofty perch in Swat, Major-General Ghani growls: “The government has enough experience of peace deals.”

The army’s progress is encouraging. On May 23rd it entered Swat’s biggest city, Mingora, where only 20,000 of around 375,000 inhabitants are estimated to remain (see map). By house-to-house fighting, the army claims to have won back half the city within a few days—including Khooni Chowk, or “Bloody Square”, where the Taliban once left the mutilated corpses of suspected spies. Atop Banai Baba Ziarat, Major-General Ghani points to more progress. To the east lies Malam Jabba, which was blessed with Pakistan’s only ski-lift until the militants destroyed it last year; it is now rid of them. To the west is Peochar, a stronghold of the local Taliban commander, Mullah Fazalullah; army commandos, dropped from the air, are reported to be advancing there.

The government is said to be mulling declaring an emergency throughout NWFP, as the army plans to extend its campaign. Heavy hints that it means to launch an offensive in South Waziristan, a Talibanised tribal area adjoining the province, have already caused an estimated 10,000 to flee it. But there is no sign

yet that the government's new fighting spirit will actually restore stability to north-west Pakistan. Where the army has captured terrain previously, including in Swat and Waziristan, the local administration has been unable to control it. This was another reason cited by the army for its many ceasefire deals. And it still fears that if the government cannot address what Major-General Ghani describes as the "deprivation, poverty and injustice" that help fuel it, the insurgency will continue.


Nor will the Taliban roll over. To explain the militants' rapid retreat in Mingora, which they had heavily mined, some pundits consider it tactical. No senior Taliban leader, they point out, seems to have been killed. Meanwhile the militants are taking the fight elsewhere. On May 26th 26 people were killed in Punjab's capital, Lahore, in a complex attack involving gunmen and a massive bomb-blast.

As the government has claimed, there is unusual public support for the army's redoubled efforts against the Taliban. Most Pakistanis do not seem to consider them a grave threat—yet the country's media are demanding they be pushed back. On May 18th most political parties signed a joint declaration of support for the army's campaign. But their unity is fragile. To win acceptance, the resolution contained no reference to the Taliban or Swat.

**India's new government**

# A well-made cabinet

May 28th 2009 | DELHI
From The Economist print edition

**The re-elected prime minister passes his first test, without merit**

AT THE age of 84, M. Karunanidhi has naturally turned his thoughts to the next generation. The chief minister of India's southern state of Tamil Nadu, he led his party, the Dravida Munnetra Kazhagam (DMK), to surprising success in the country's recent general election. The DMK won 18 of the 22 seats it contested. Emboldened, Mr Karunanidhi asked for five of the new government's 30-odd cabinet jobs, two more than the DMK had in the last government. That would enable him to accommodate two loyal protégés, T.R. Baalu and A. Raja, and still have room for his relatives: his daughter, Kanimozhi; one of his sons, M.K. Azhagiri; and his grandnephew, Dayanidhi Maran.

This proposal, combining nepotism and cronyism, presented Manmohan Singh, the Congress party's prime minister, with the first test of his new authority. He was sworn in for a second term on May 22nd, after Congress won a surprisingly thumping victory in the election, with 206 seats. Alas for Mr Karunanidhi, this has enabled Congress to drive a harder bargain with its allies than in 2004, when it won the previous election with 145 seats.

Mr Singh said he could have just three ministries, the same number held by the DMK in the previous government. Mr Karunanidhi quit Delhi in a huff, threatening to withdraw from the government. But he quickly relented.

In fact, he should be pleased. It was briefly rumoured that Mr Singh would also reject Mr Karunanidhi's lieutenants, Messrs Baalu and Raja, among several former ministers of the previous government who are generally considered to have performed abysmally. Bowing to coalition convention, however, the conciliatory Mr Singh said Mr Karunanidhi could fill his allotted posts as he chose.

It therefore looked likely that Mr Raja would return to the telecoms ministry, where in 2008 he sold the nation's airwaves at bargain prices, depriving the exchequer of much-needed cash. Mr Baalu may be less lucky. He looks unlikely to return to the cabinet where, as transport minister, he prompted the resignation of five chairmen of the National Highways Authority of India and scared away bidders for India's national road-building contracts. His exit would make room for Mr Karunanidhi's son and grandnephew, who may claim the ministry of textiles and the ministry of chemicals and fertiliser.

This tedious horse-trading was followed enthusiastically in India. Given Congress's surprisingly strong showing, many are anxious to see signs that its new coalition government will be more coherent and efficient than its previous one. Moreover, in a country now addicted to political news after a month-long election, Mr Karunanidhi's trials have made a rare post-results controversy. Congress's choices for the main ministerial jobs were reasonably straightforward. The new finance minister is Pranab Mukherjee, who was foreign minister in the previous government. He is succeeded in that job by S.M. Krishna, a former chief minister of Karnataka. Palaniappan Chidambaram remains home minister; A.K. Anthony stays on as defence minister.

Mr Mukherjee's was the only one of these appointments to generate mild ambivalence. A veteran political warhorse who first entered the cabinet in 1975, he was previously finance minister from 1982 to 1984, under Indira Gandhi. That was a different era, in which the ministry pulled the economy's strings, choosing what companies could import and how much they could produce. A fixer not a visionary, Mr Mukherjee was not the obvious choice to steward today's more open and vibrant economy. Then again, it should not take a visionary to attain India's goal of annual growth of 9%. The impediments to that goal are mostly practical, not conceptual; political, not economic. A wily Congress fixer may be as qualified to overcome such obstacles as anyone.

Sri Lanka's war

# After the slaughter

May 28th 2009 | COLOMBO
From The Economist print edition

**The Tamil Tigers contemplate life without Prabhakaran**

ONLY days after Velupillai Prabhakaran was found dead on a battlefield in north-eastern Sri Lanka on May 19th, cracks have emerged in the Tamil Tiger rebel group that he controlled for over three decades. At issue is whether to concede that Mr Prabhakaran, whose pudgy corpse was displayed for television cameras by the army and then burned, is really dead.

On May 24th Selvarasa Pathmanathan, head of international relations for the Liberation Tigers of Tamil Eelam (LTTE), as the group are properly known, said its “incomparable leader and supreme commander” had been martyred. Within hours, another self-described Tiger faction, quoting the Tigers’ intelligence arm, released a statement that said, the “LTTE leadership is safe and it will re-emerge when the right time comes”. The Tigers’ intelligence chief, Pottu Amman, is the most senior rebel plausibly rumoured to have survived the murderous last stage of a two-year army offensive. In a 48-hour slaughter, which followed the escape of the last of a refugee horde whom the Tigers had sought to hide behind, several hundred rebels leaders and fighters were killed by the army. Some had attempted to surrender, including two political LTTE leaders, B. Nadesan and S. Puleedevan. They and their families are reported to have been machinegunned while advancing under a white flag.

According to D.B.S. Jeyaraj, a Canada-based Tamil commentator, the Tigers are torn between those who want to acknowledge Mr Prabhakaran’s death and move on, and those wanting to perpetuate the myth that he is alive. A powerful incentive for the latter is their realisation that the Tigers’ ability to shake down the Tamil diaspora for funds will be weakened by their leader’s death.

AFP

**Prabhakaran: a tattered memory**

By contrast, Mr Pathmanathan says the rebels are ready to quit violence and enter a democratic process. But Sri Lanka’s government, dominated by a powerful national-security cabal under Gotabhaya Rajapaksa, a brother of President Mahinda Rajapaksa, will not allow this. Defying calls for an urgent effort at reconciliation with its battered Tamil citizens, the government announced on May 26th that a wartime state of emergency will remain in force. Many Tamils fear a nationwide crackdown on anyone suspected to have had links with the LTTE. There are already reports of pro-government Tamil militiamen hunting for Tiger sympathisers among some 200,000 inhabitants of the Tigers’ former fief, currently interned by the government in wretched camps.

European countries, led by Britain, France and Germany, are meanwhile demanding an international investigation into war crimes allegedly committed by both sides in the war’s last phase. According to the UN’s conservative estimate, more than 8,000 refugees were killed on the battlefield this year, mostly in a government-designated “no-fire zone”. And there is mounting evidence, including testimony from those who escaped it, to suggest that army bombardments were mostly to blame for this. Many refugees have also accused the LTTE of shooting at them to try to prevent their escape.

On May 25th the United Nations Human Rights Council convened a special session on Sri Lanka following a request submitted by Germany on behalf of 17 mostly European countries. Its members proceeded to vote down a proposed resolution decrying the Sri Lankan government’s disregard for civilian life. But another draft resolution tabled by the Sri Lankan government itself, praising its own commitment to human rights, was passed by a vote of 29 to 16. Its motley crew of supporters included China, Cuba, India, Russia, Pakistan and Egypt.

Nepal's political crisis

# Mr Nepal lucks out

May 28th 2009 | KATHMANDU
From The Economist print edition

**But his country, of the same name, is struggling**

ON MAY 23rd Madhav Kumar Nepal, the communist son of a Hindu priest, became Nepal's new prime minister. He succeeds Pushpa Kamal Dahal, the country's former Maoist leader—the main protagonist in a decade-long guerrilla war—who resigned on May 4th, leaving the government in limbo. Mr Nepal has the support of 21 of the 24 political parties in Nepal's assembly; but this is scarcely democratic progress. The Maoists, who won 38% of the assembly's seats in the country's first post-conflict election last year, do not support him. Nor did Mr Nepal win either of the two seats he contested in the poll.

Among many threats to his new government, the Maoists loom large. Mr Dahal, who resigned after he was foiled in an effort to sack an old enemy, Nepal's army chief, General Rookmangud Katawal, has said they remain committed to democracy. Yet the Maoists had until last week stopped the assembly functioning since their chief's resignation. And they still demand that the president, Ram Baran Yadav, should reverse his decision to veto General Katawal's sacking. Backed by Mr Nepal and his allies, who consider the army a last defence against the Maoists, Mr Yadav will not do this. On May 24th the Maoists spurned an invitation to join the new government.

With luck, it may survive for a while. It might even try easing the country's severe power and fuel shortages. That would quell some of the growing discontent at the failure of any party to deliver on its election promises. But the early signs are not promising, with Mr Nepal's coalition partners bitterly feuding over the division of cabinet spoils.

More important, there seems little prospect of this government making much progress on the assembly's two main tasks—shepherding a complicated peace process and drafting a new constitution. Under Mr Dahal's more solid government, including the Maoists, Mr Nepal's UML (for Unified Marxist-Leninist) and other parties, these were daunting: the thorniest issue of the peace process, the fate of 23,000-odd former Maoist fighters, led indirectly to its demise. (Some of these fighters are to be recruited into the army; but General Katawal, to the Maoists' fury, has resisted this.) And if Mr Nepal's government cannot resolve these issues, it had better make way for one that can.

Twenty years after Tiananmen

# Silence on the square

May 28th 2009 | BEIJING
From The Economist print edition

**Outside the Communist Party, memories of the 1989 massacre get hazy**

AMONG journalists at a Chinese newspaper, there has been some surprising talk of publishing a story to mark the 20th anniversary on June 3rd and 4th of the massacre of hundreds of Beijing citizens by Chinese soldiers. One journalist even told his colleagues he would be ready to go to jail for doing so. But such bravado, especially if it proves more than rhetoric, is likely to be rare. For many in China the nationwide pro-democracy protests of 1989 and their bloody end have become a muddled and half-forgotten tale.

This does not stop the Communist Party worrying about the issue. It fears that the efforts of even a small number of people to keep memories alive could be destabilising. The most senior official to serve jail time for his role in the Tiananmen Square unrest, Bao Tong, has been escorted by security officials from his Beijing home to a scenic spot in central China (far from muttering journalists) where he will spend the anniversary period. Mr Bao agreed to go, says a family member. But in China an invitation from the police can be awkward to refuse. Several other dissidents report heightened police surveillance.

This year's anniversary has spurred a hardy few to pronounce on the massacre. A Beijing academic, Cui Weiping, told a gathering of intellectuals called to commemorate it that the party's campaign to deter public discussion of Tiananmen, and public acquiescence to it, had damaged China's "spirit and morality". She posted her remarks on her blog.

Another source of official concern was the recent publication abroad of a book containing the damning contents of tapes secretly recorded by Mr Bao's boss, the late former party chief, Zhao Ziyang, during his post-Tiananmen house arrest. The book portrays Mr Zhao as a victim of scheming hardliners and as a principled opponent of using force to crush the unrest (though he was not, until his house arrest, an admirer of Western-style democracy). A retired senior official has confessed that he and three others helped squirrel the tapes from Mr Zhao's confinement.

The party has also tried to deflect attention from the army's contribution to the slaughter. Twenty years ago the official media repeatedly sang the praises of dozens of soldiers killed during the "counterrevolutionary rebellion"—and posthumously considered "guardians of the republic". Now they are all but forgotten. Meanwhile, public support for the armed forces, which was badly damaged in 1989, appears to have rebounded. The army's rapid response to the deadly earthquake in Sichuan Province a year ago, a gift to party propagandists, played a part in this. When tanks roar through Tiananmen Square on October 1st in a grand parade to celebrate China's national day (the second such display since 1989), they will be greeted with widespread approval from a nation hungry for symbols of China's growing power.

Reuters

But the party still betrays occasional signs of worry about the armed forces. Shortly before and after the mass killing in Beijing in 1989, there was widespread speculation that some in the army objected to it. Yet the prospect of serious dissent in the army proved largely unfounded. There is no hint in Mr Zhao's tapes that he had the support of any top brass. Nonetheless, in recent months the official media have published several articles denouncing calls (from whom is not specified) for the armed forces to be removed from the party's direct control. The party worries this would weaken its ability to count on them in the event of another Tiananmen-type crisis. The tone of these articles is oddly strident—perhaps suggesting this mooted reform has support within the armed forces.

The party's control is not absolute. President Hu Jintao launched yet another campaign this month against "extravagance and waste" among senior officers. For all such efforts, corruption within the armed forces remains widespread. But so too is corruption within the party. Mr Hu may enjoy nothing like the kind of prestige that China's late leader, Deng

Xiaoping, had in the armed forces in 1989 when he ordered the troops into Tiananmen. But there are still few obvious signs of strain between the political and military leaderships. A rapid increase in the military budget in recent years has no doubt helped.


Faceless and faithful?

Among ordinary Beijing citizens, there is a generational divide on Tiananmen. Many who took part in or witnessed the unrest still grumble about the party's brutal response. But younger folk are often confused about the details of it. Many say they accept the party's line that the economic boom which followed has vindicated the armed forces' bloody intervention.

### But once they've seen Paree…

Yet the only place in China where Tiananmen remains a public issue is its richest, Hong Kong. Thousands are expected to attend commemorative events in the territory. Earlier this month its chief executive, Donald Tsang, apologised after an uproar over his seemingly innocuous suggestion that many Hong Kong citizens believed Tiananmen "took place a long time ago" and that China had made "remarkable achievements" since then. Many in Beijing would certainly agree with Mr Tsang. But unlike those in Hong Kong, they have not tasted democracy.

**Banyan**

# The party goes on

May 28th 2009
From The Economist print edition

**Who, 20 years ago, would have thought that the Communist Party could come to this?**

Illustration by M. Morgenstern

WHEN the tanks departed Beijing after the crackdown of June 1989, no one with an interest in China thought the matter ended. The Chinese Communist Party had won its battle for survival, but the war seemed unwinnable. All the more so after communism collapsed in Eastern Europe later that year, followed by the Soviet Union. Even China's lunge for breakneck growth from 1992 looked set to accelerate forces the party might not control. As the party's ideological and moral foundations crumbled, it was no longer clear what on earth it stood for.

China-watchers' scenarios ran from party collapse to a democratising path. As late as 1998 Bill Clinton was able to tell his Chinese host, President Jiang Zemin, that suppressing dissent put China "on the wrong side of history". Banyan was in the audience that day, his Flying Pigeon (state-made bicycle) outside. Mr Clinton's words seemed self-evident. But with hindsight, much of where the West said China was going was wishful thinking.

What nearly no one predicted has transpired. Today, the party is as strong at home as at any time since it seized power in 1949. Though still authoritarian, it rules largely by consent, preferring persuasion to violence and intimidation—though these remain handy, as during the crushing of Tibetan riots last year.

Abroad, its prestige is as high: some believe China's economy is about to save the world. Mr Jiang's successor, Hu Jintao, has been welcomed at the top table of world leaders. On her first trip to Beijing as secretary of state, Hillary Clinton was as blunt as her husband had been a decade earlier, but with a different message: the United States would not let China's human-rights abuses obstruct the history being made between these two great states.

It is a commonplace that the party's legitimacy is built on economic growth. Yet China's leaders have long considered that to be merely the (simplistic) half of it. After the massacre, the Communist Party set about transforming itself. It launched a vast historical investigation into how political parties fall, and how they stay in power. Everyone was scrutinised, from Saddam Hussein to Scandinavian social democrats. The conclusion: adapt or die.

The outcome is a wholesale reinvention of the party, a process accelerated after Mr Hu stepped up as paramount leader in 2004. Shortcomings that were identified included corruption (a chief complaint of the

Tiananmen students), lack of accountability in decision-making, no convincing ideology, and an ossified structure. In a recent book ("China's Communist Party: Atrophy and Adaptation"), David Shambaugh describes how the 74m-strong party has fired whole armies of time-servers. Bright technocrats and entrepreneurs have been recruited. Retirement rules have been revamped (the Soviet Union's gerontocracy was noted). Party members have gone back to school: three weeks a year and three months for every three years of mid-career training. More appointments are open to peer scrutiny before they are filled. The Communist Party is vastly more able to govern.

Some in the wishful West will see this as a proto-democratisation of a Leninist state. The opposite is the case. Staying in power is the party's only credo now that revolution has been jettisoned. It is the sole reason for revamping the mechanisms of power.

## China's other manufacturing industry

A case in point is the Communists' approach since 1989 to the crucial field of propaganda. With the end of Maoist mobilisation, the party turned to Western techniques of public relations and mass media, manufacturing consent by guiding public opinion in certain directions while barring it from others. In "Marketing Dictatorship", Anne-Marie Brady sums up the party's approach as emphasising achievements, not allowing bad news during holiday periods or around sensitive dates (including June 4th), and not raising problems that can't be solved (unemployment, inequality). It talks up the economy, regularly demonises the United States and uses Orwellian newspeak to shape the debate about certain subjects ("party-state" is banned in public discourse in favour of "the political party in power"). It presents stories in ways that encourage people to take sides. It turns natural disasters into quasi-religious occasions of national solidarity. And always, always repeat after me: "Taiwan is an inalienable part of China."

With this approach, the proliferation of channels for media, information and entertainment offers unbounded scope for the party to get its messages across, abetted by commercial operators. The internet has proven a particular boon, since its users are predominantly young, educated males from the cities—just the kind of groups, the party has noted, behind the colour revolutions in Serbia, Georgia and Ukraine. Shaping the online debate while using controls and surveillance to block most of what it does not want surfers to see, the internet is an example of how the party has corralled mainland Chinese into what Ms Brady calls "a virtual mind prison"—though one with plenty of fun and games to keep people entertained. In 2000 Mr Clinton said that trying to control the internet in China was "like trying to nail Jell-O to a wall". The Communist Party seems to have managed it.

This is little comfort to Westerners projecting their hopes for democratic change on to China. Nor is there any sign that Chinese intellectuals identify with the myriad grievances of their poor countrymen, as they did during the Tiananmen protests. And the growing middle class appears more fearful of the great unwashed than of the depredations of a party that once was at war with the bourgeoisie. So no national movement challenges the party's monopoly. The state might yet prove unable to meet growing demands for health care and schooling. Leadership splits might threaten the party, as they did in 1989, with China now facing its biggest economic test since then. But for now, the Communist Party glides smoothly upon the tide of history.

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Economist.com/blogs/banyan

Lebanon's election

# Will the shaky equilibrium hold?

May 28th 2009 | BEIRUT
From The Economist print edition

**Despite its history of turbulence and the continuing rise of the Shias, Lebanon's fragile peace may persist—at least for a while**

AP

WITH a general election on June 7th, Lebanese passions are running high. Brazen posters festoon every public space, coding party fiefs by colour: blue for the party of the Future, orange for the party of Change and yellow for Hizbullah, the party of God, alongside a dozen other hues. Noisy rhetoric reverberates in street brawls and kitchen squabbles.

Lebanon is not just another small, combustible Mediterranean country of 4m people. It has a most unusual form of democracy, based on quotas for each of the 16 recognised sects in its 128-strong parliament. This mix of minorities, confused by divisions within sects and ever-shifting alliances inside and between them, has a tendency to explode, as it did during Lebanon's gruelling civil war in 1975-90. The country is also a cockpit for wider struggles. With outsiders such as Iran, America, Syria and Saudi Arabia throwing their weight behind competing factions, the electoral outcome will inevitably be seen as a test of their relative strengths.

America and its allies want the current parliamentary majority, a shaky coalition of Sunni Muslims, Druze and assorted Christians, to retain the hold it gained in the previous election, in 2005, when it swept to power on a wave of popular anger following the murder of Rafik Hariri, a five-times prime minister and Sunni strongman.

Iran and Syria, whose peacekeeping army dominated Lebanon until its hasty withdrawal after Hariri's murder, seek victory for the challengers, an alliance of disgruntled Christian factions led by Michel Aoun, a nationalist former general, and two Shia parties, Amal and Hizbullah, which field militias that harried Israel during its occupation of south Lebanon in 1978-2000 and which again battled the Israelis in a short but bruising war in 2006.

The outsiders are not subtle in their use of influence. America recently dispatched its vice-president, Joe Biden, on a quick visit. While expressing hope for a clean election, he held a private meeting with leaders of the current majority, known in Lebanese shorthand as the March 14th group, and hinted that a win for their foes could jeopardise the aid America has lately lavished on the Lebanese army to reinforce it in the face of Hizbullah's militias, which remain superior in training, equipment and morale. For his part, President Mahmoud Ahmadinejad of Iran, which has showered equally large sums on its Lebanese protégés, predicts that their victory will bolster the "resistance"—to Israel and the West—and change the

balance of power in the region.

But although some opinion polls suggest a slight lead for the opposition, the result may well be close. Oussama Safa, a political consultant, reckons that, given loyalties within the sectarian patchwork of voting districts, the two main alliances are each guaranteed around a third of the seats, leaving only a third of them in play.

In Lebanon’s multi-seat constituencies, parties encourage block voting by distributing ballots printed with their list of candidates, but voters can still cross out some names and write in others. Recent redistricting should give previously muted voices a bigger say. For instance, barely 4% of the large Armenian electorate in the capital, Beirut, bothered to vote in 2005, despite having four seats allotted to them. They complained that their allocation was in constituencies dominated by Sunni voters, so the Armenians who were elected were unrepresentative of their own community. This time their votes will count for more. In some districts 50 votes, says Mr Safa, will make a difference.

Yet the result may not produce radical change. Since the 2006 war with Israel, the two main coalitions have become more polarised. The one led by Hizbullah says it won a “divine victory” against the Jewish state in the five-week war, whereas March 14th supporters still say the Shia militia must be disarmed and blames it for provoking an Israeli onslaught that caused widespread destruction and killed 1,200 Lebanese, mainly civilians.

Last year Hizbullah and its allies, frustrated by March 14th’s refusal to bow to their demand for a blocking share of seats in the cabinet, humiliated their opponents by staging a swift takeover of Sunni strongholds in Beirut. This move prompted March 14th to climb down at a reconciliation conference in Qatar. But the fighting infuriated Sunnis, frightened some of Hizbullah’s Christian partners and has left the squabbling parties suspended in a precarious equilibrium.

This, no matter what the election result, looks likely to be maintained, at any rate in the short run. Even if the March 14th group keeps a slim majority, it cannot counter Hizbullah’s street power under the charismatic leadership of Hassan Nasrallah, a bearded cleric who inspires fierce loyalty. Nor can it stop Hizbullah’s quietly effective infiltration of key institutions, such as the army. In fact, some March 14th leaders already sound willing to accommodate their foes. The Druze chief, Walid Jumblatt, a weathervane of Lebanese politics and until recently a loud critic of Iran and Syria, has taken to exchanging compliments with Mr Nasrallah. A leaked recording of Mr Jumblatt in a private meeting revealed him disparaging his own coalition allies.

Yet the opposition alliance has weaknesses too. The Christian supporters of General Aoun feel slighted by the March 14th coalition and say that it is corrupt, but regard their own alliance with Hizbullah as tactical rather than strategic. Despite verbal support for the Shia movement, few Christians, whose own militias from the civil-war era were largely disarmed, are comfortable about Hizbullah’s growing military strength. And Hizbullah itself is uneasy with parliamentary politics. Fearing that it might be blamed for any future government’s failings, including a possible collapse of international support for the debt-ridden economy, it is fielding just 11 candidates, down from 14 in 2005, and may even give up its two cabinet posts.

Lebanon is used to fractious politics. Despite the years of turbulence, its economy is humming along nicely. It may tolerate another period of muddle and perhaps even emerge with a stronger centre, joining moderate parts of both the current coalitions. But the volatility is bound to persist. When a report in *Der Spiegel*, a German weekly, implicated Hizbullah agents in Hariri’s murder and in those of nine other people associated with March 14th, even the leaders of March 14th scuttled to defuse the bombshell, fearing the fallout across the country. Stability in Lebanon should never be taken for granted.

Israel and its Arabs

# No, you can't say that

May 28th 2009 | JERUSALEM
From The Economist print edition

### A bill that would muzzle Arab-Israelis

Reuters

**The Palestinians get up Lieberman's nose**

A BILL to outlaw expressions of grief or mourning on the anniversary of Israel's independence is unlikely, in the end, to get onto Israel's statute book. Even if it did, it would probably be struck down by the Supreme Court. Still, the bill's endorsement on May 24th by the cabinet committee on legislation sent a shudder through liberal circles in the Jewish state—and appalled Palestinians everywhere. For it was a sign that the anti-Arab campaign of the new foreign minister, Avigdor Lieberman, earlier this year was not just electoral hype.

"This is a Zionist and patriotic bill," said Alex Miller, a parliamentarian in Mr Lieberman's party, who submitted it. Palestinian Israelis who mark Israel's independence day as their people's *nakba* (catastrophe) "exploit the democratic and enlightened character of the State of Israel in order to destroy it from within"—and would be punishable under the bill by up to three years in prison.

Next on the agenda of Mr Lieberman's party, Yisrael Beitenu (Israel Our Home), is a "loyalty law" to require an oath of allegiance to the state on pain of forfeiting citizenship, or, in a less draconian version, welfare benefits. This, too, is aimed at citizens of Arab origin who make up a fifth of Israel's 7m people.

Yisrael Beitenu's success in the election in February, when it came third with 15 of the parliament's 120 seats, made Mr Lieberman the kingmaker. Tzipi Livni, leader of the centre-left Kadima party, which won most seats but struggled in vain to form a ruling coalition, wooed him assiduously, turning a blind eye to his views on human rights but making much of his acceptance of a two-state solution for Israel and Palestine. But Mr Lieberman plumped for his "natural allies" such as Binyamin Netanyahu's Likud on the hard right.

As Mr Netanyahu's foreign minister, Mr Lieberman now plays down his previous acceptance of the two states, which the prime minister balks at. Opponents of the Palestinian state have joined Mr Lieberman's cohorts in defending the *nakba* bill. "In this Knesset [parliament]", observes a veteran Arab-Israeli member, Ahmad Tibi, "anything that's anti-Arab can pass, even if it says the sun rises in the west." As if to prove his point, on May 27th a private member's bill was passed at a preliminary reading to make it a crime to publish opposition to Israel's existence as a Jewish and democratic state, if such publication is likely to lead to "acts of hatred or contempt or disloyalty to the state."

But the Labour party, Mr Netanyahu's junior coalition partner, says it will leave the government unless the *nakba* bill is withdrawn. Three of Mr Netanyahu's ministers oppose it. It may yet be buried.

Iraq's Kurdish oil

# Kurdistan goes glug glug

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**The federal government is letting Iraq's Kurds export from their new oilfields**


ON JUNE 1st a man in a hard hat in the blazing sun will ritually turn a switch to let oil flow through a pipeline. In oil-rich Iraq that should not warrant comment. But this operation, at the Tawke oilfield near Iraq's northern frontier with Turkey, will be beamed live to a giant screen in a new conference centre in Erbil, capital of Iraq's self-ruling Kurdistan region. Hundreds of leading Kurds will cheer as they watch pictures of oil being offloaded from tankers at an export facility at Khurmala, south-west of Erbil, from which it will be pumped to Baiji and into the same northbound pipeline (see map).

The reason for the excitement is that the crude is being extracted from the first newly developed oilfield to have come on stream since the Americans invaded Iraq in 2003—indeed, the first to have come on stream anywhere in Iraq for 30-odd years. It is also the first instance of exploration leading to extraction and export by private companies in Iraq since oil was nationalised in 1972. Iraq's Kurds, who have signed a string of controversial production-sharing agreements (PSAs) with private companies, are proud that the oil is flowing anew from fields that they control.

The oil ready for export comes from two fields. One is at Tawke, developed by DNO International, a small Norwegian firm. The other is at Taq-Taq, where Addax Petroleum, listed in London and Toronto, runs a joint venture with Turkey's Genel Enerji, which also has a stake in the Tawke show. Ashti Hawrami, the Iraqi Kurds' natural-resources minister, praises the Turkish companies involved. Relations between Turkey's government and the Iraqi Kurdish regional one are plainly improving.

The Tawke field will start by pumping 60,000 barrels a day (b/d). A new pipeline will carry the crude from the wells east of Zakho to join the main northern pipeline on the Iraqi side of the Turkish border. Meanwhile 40,000 b/d will be trucked from the Taq-Taq site to Khurmala. The crude from both fields will flow through Turkey to the Mediterranean port of Ceyhan. Mr Hawrami says the new fields should produce 450,000 b/d by 2011 and 1m b/d by the end of 2012. That would represent 42% of Iraq's production, if output from the rest of the country stays the same.

The operations at Taq-Taq and Tawke are run under PSAs whereby private companies get 10-20% of the profit. The rest goes to the federal government in Baghdad before being distributed across the rest of Iraq. But Iraq's oil ministry and its trade unions dislike PSAs. A long row between the Kurds and the authorities in Baghdad over rules for the north has yet to be resolved. Baghdad wants to approve all oil deals. The Kurds say the federal constitution lets them run—and profit from—their own oil industry, though they accept that revenue should somehow be shared. The Kurds' parliament passed a hydrocarbons law in 2007. But a new national oil law has been stalled in the federal parliament in Baghdad for at least three years.

The Kurds say they have shown up the decrepitude of Iraq's oil establishment. Despite billions of dollars of investment since 2003, production is still just over 2m b/d, about what it was when Saddam Hussein was toppled. The federal oil minister, Hussein al-Shahristani, loathes the Kurds' success and has tried to stop them running their own oil industry, declaring all deals (now at least 20) signed by them to be illegal. He has also threatened to blacklist any oil company that does business up north from applying for licences down south.

But the global recession may be helping the Kurds. The fall in the oil price has played havoc with the central budget. Iraq needs cash quickly. That, presumably, is why the federal government was forced to let the Kurds export oil off their own bat.

Sierra Leone and its diamonds

# Digging in the dumps

May 28th 2009
From The Economist print edition

**Diamonds are a luxury—but not to some of the world's poorest who mine them**

Panos

A less than brilliant job

THE people of Sierra Leone's Kono district, in the east of the country, know all too well about diamonds—for better and for worse. In the 1990s, the drugged-up rebels of the Revolutionary United Front controlled Kono's mines by means of rape, murder and mutilation. When that bloody civil war ended in 2002, mining companies replaced the rebels but brought their own problems. The largest firm, South Africa-based Koidu Holdings, was pitted against locals over blasting schedules and environmental issues. Small-time local miners, little more than licensed freelancers prospecting by hand, were disappointed to find that most of the mines near the surface had been exhausted. The jobs, the volume of production and Kono's cut of tax revenue from exports disappointed almost everyone. "Progress in Kono has not been commensurate with expectations," admits Ibrahim Kamara, who runs a kimberlite project for Koidu Holdings.

Such are the growing pains of a nascent industry in a dirt-poor African country. Yet Sierra Leone's diamond mining has shown promise. Exports ballooned from a mere $26m in 2001 to $141m in 2007. Taxes on diamond exports helped finance the country's post-war reconstruction; a quarter of the 3% tax on sales paid by artisanal miners, as the local small-timers are known, is returned to the people who live around the mines. Bigger companies, such as Koidu Holdings, have negotiated profit-sharing schemes that will benefit the locals once the mines start making money.

But now that virtuous circle may be broken by the collapse in the past ten months of world diamond prices, which have plummeted by nearly one-third. The country will be lucky to export $50m-worth this year. From Australia to Botswana and Canada, the industry is in the doldrums. Over the past few months De Beers, until recently the world's biggest diamond producer, has seen the value of its "sights"—carefully calibrated sales of rough diamonds to a handpicked club of buyers called "sightholders"—fall from an average of $650m to a recent low of around $150m. In response to collapsing demand, mining companies have been temporarily closing mines or reducing production. This does not hurt countries such as Australia and Russia all that much. But it squeezes poorer ones, particularly in Africa, very hard.

Earlier this year, for instance, De Beers temporarily shut mines in Botswana and Namibia that it owns in partnership with those states. At least three-quarters of the companies in Namibia's young cutting and polishing industry have closed. "We are suffering quite severely because of job losses," says Bernhard Esau, Namibia's deputy minister for mines. In India, home to the largest diamond cutting and polishing industry in the world, at least 100,000 diamond polishers are out of work. America, where half of all polished diamonds are eventually sold, is importing less than half the volume of polished diamonds compared with a year ago. "Diamonds are not necessary to live or to survive. It's a luxury product," said Philip Claes of the Antwerp World Diamond Centre, the industry's leading promotional organisation. "So it's the first thing probably that consumers skip on their lists."

But Sierra Leone relies on those consumers to help prevent it from slipping back into chaos. When Koidu Holdings temporarily halted operations and laid off 540 people, leaving only 60 in work, it was especially nerve-racking. For Kono has the highest concentration of former rebel fighters in Sierra Leone. Despite political stability and fairly harmonious elections since the war ended, the conditions that led to it still prevail. Back in 1991, the rebels gained early if short-lived support by arguing that a country as mineral-rich as Sierra Leone should give all its people a decent living. Yet it was at the bottom of the UN's human-development index when the war started—and is still at the bottom. There is "a time bomb of frustrated, disenfranchised youth", says Joan Baxter of Partnership Africa Canada, a charity.

The diamond slump may have reached its bottom. The De Beers latest sight, last month, was worth around $250m, up on previous months. Some mines in Botswana have cautiously resumed operations. In Sierra Leone, Koidu Holdings says it will rehire a few hundred workers as the market improves. None of this is a guarantee against unrest. But a return to the diamond-fuelled warfare of the 1990s seems unlikely soon. For one thing, even rebels would have trouble finding a market for ill-gotten gemstones at present.

Besides, the diamonds’ recent lack of lustre may bring unexpected benefits. Many artisanal miners are going back to farming. In a country where food prices have doubled in a year, this is welcome. And companies are looking for other minerals that Sierra Leone has in abundance, such as gold, bauxite and rutile, a mineral that is used—among other things—to brighten the whiteness in paint, plastic and paper. In the longer run, a bit of diversity may be healthy.

**Fighting in Nigeria's Delta**

# Getting desperate

May 28th 2009 | LAGOS
From The Economist print edition

**Will the government's latest effort to bash the militants get more oil flowing?**

EPA

We won't MEND your pipeline

A SPECIAL federal task-force set up to help restore peace in Nigeria's oil-rich but troubled Delta region has launched a wave of attacks on a militants' camp, ending months of relative calm in the region. It is too soon to say whether it will squash the armed gangs and let the battered oil industry reassert itself in the area. In the short run, it may even have made things worse. Without a doubt, a lot of people have been killed.

After the government made overtures towards the Delta militants nearly a year ago, about eight months of relative peace ensued. As oil prices fell, so did the rate of oil theft and pipeline sabotage. But local human-rights campaigners say that since May 15th helicopters and naval gunships have killed hundreds of civilians and displaced thousands more. Government forces, they say, have shown scant regard for civilians.

The fighting is mainly in an area in the southern Delta state near the Escravos oil terminal, run by an American oil company, Chevron, where much of the crude that makes Nigeria Africa's largest exporter is processed. With few roads or modern connections and plenty of swamps, government forces can hammer the militants—and the civilians among whom they live—with little scrutiny from outside.

The area's main militant group, the Movement for the Emancipation of the Niger Delta, known as MEND, said it would move a British hostage, whom they have held since September, to the battle zone as a human shield. Echoing threats it made at the height of violence two years ago, MEND also told all foreign oil workers to leave the region for their own safety. Its additional threat to block the Delta's waterways, which would disrupt oil exports even more, helped nudge world prices back up to $63 a barrel. On May 25th, MEND said it had blown up one of Chevron's biggest pipelines in retaliation for the army's offensive. The company had to shut off part of its output.

The militant camp the government is smashing is run by a local man known as Government Tompolo, who had been aligned with MEND but fell out with it after he was rumoured to be negotiating with state officials trying to persuade him to close his camp in return for handsome pay-offs for him and his friends. But the army comes under federal authority and is removed from decisions by officials of the state. No one is sure what sparked the latest wave of attacks but it seems likely that Mr Tompolo's "boys" engaged the army in a series of skirmishes, provoking it to hit back as hard as it could.

MEND says it is fighting for a fairer share of the country's oil revenue to go to the dirt-poor people who live in the area. But the Nigerian government says that MEND and other armed groups in the region are just criminals who sow chaos in order to steal vast amounts of the country's crude oil, about a tenth of which is reckoned to be stolen before it reaches the export terminals. Aerial photographs of the Delta show dozens of tankers illegally linked to pipelines, siphoning off millions of barrels of crude for sale abroad. According to security experts, theft on such a scale requires the co-operation of large numbers of senior people in Nigeria's navy.

In any event, banditry and insurrection in the Delta, which got out of hand in 2006 and worsened in 2007 with the emergence of MEND, have reduced Nigeria's oil output by as much as a quarter. When Umaru Yar'Adua won the presidency two years ago, he promised to restore stability in the area. He has failed to do so. Oil monitors say Nigeria has been producing about 1.6m barrels a day, barely two-thirds of its quota set by OPEC, the Organisation of the Petroleum Exporting Countries.

**Africa's economies in the downturn**

# Prudence can win

May 28th 2009
From The Economist print edition

**The IMF says some African countries can spend their way out of recession**

WHEN demand collapses in an economy, the governments of rich countries can try to compensate by spending more of their own money. But poor countries have rarely risked such counter-cyclical fiscal expansion. Limited cash, and worries about debt, usually mean they must cut spending rather than increase it when times are tough and revenues dip.

This could change if the IMF has anything to do with it. Recent missions of the Fund to Tanzania and Mozambique have explicitly advocated fiscal stimuli. This is rather new for the IMF, which has rarely advocated loosening purse strings in poor countries. But its economists believe that some sub-Saharan Africa countries are better placed to implement fiscal expansion in this crisis than in previous ones.

This is not because government revenue is unaffected. Government finances in such countries as Angola, Botswana, Chad, Congo and Nigeria, which rely heavily on the export of commodities, are being pummelled. In general, budgetary targets in the region are increasingly not being met as economic activity slows.

Still, the IMF argues that declining revenue is less of a constraint now than before. Growth averaging 6.5% a year between 2004 and 2008, together with buoyant commodity prices, meant that African governments were flush with cash during the boom. But instead of overspending in good times, as they had historically tended to do, some, such as Tanzania and Mozambique, wisely built up their reserves. This may stand them in good stead now that times are tough. Debt relief has also helped: three-fifths of sub-Saharan African countries have what the IMF considers sustainable debt positions, adding to an argument for fiscal expansion.

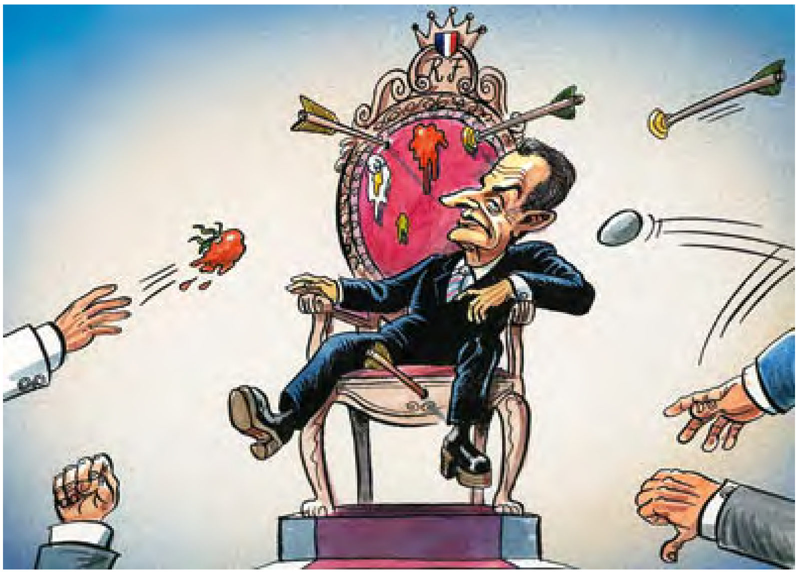
**Nicolas Sarkozy and France's opposition**

# All the president's enemies

May 28th 2009 | PARIS
From The Economist print edition

## Why French politics is turning nasty and personal

Illustration by Peter Schrank



WHEN President Nicolas Sarkozy introduced a tough law earlier this month to cut off internet access for those who illegally download music and films, it ought to have appealed to France's arty left. It has long cherished the "French cultural exception", the idea that culture has a special value and needs protection.

French singers and actors urged the opposition Socialists to back the law. In the end, though, the Socialists voted against it, as did the Communists and Greens. And many did so because of their antipathy to the man who devised the law: Mr Sarkozy. "Systematic anti-Sarkozysm can make us lose our common sense," commented Jack Lang, a former culture minister and the only Socialist deputy to vote in favour.

Two years into Mr Sarkozy's term in office, intense and obsessive dislike of the president—*anti-sarkozysme*—is fast becoming the defining feature of French opposition politics. This goes beyond the president's poor popularity rating, which fell another four points to 32% in May, according to TNS Sofres. In the election for the European Parliament, due on June 7th, the subject is not so much the future of Europe as Mr Sarkozy himself. The Socialist Party, for instance, is campaigning on an anti-Sarkozy platform. One of its slogans is "Stop Barroso, stop Sarkozy!", a dig at both the presidents of the European Commission, José Manuel Barroso (considered too liberal in economic policy) and of France. On the far left, the New Anti-Capitalist Party is calling for a "vote against Sarkozy and the Europe of capitalists".

Or take François Bayrou, a centrist leader, who kicked off his campaign by publishing a vitriolic book entitled "Abuse of Power". Describing France under Mr Sarkozy as an "egocracy", he refers to the president variously as "a blind monarch" and "a barbaric child", who "believes himself all-powerful and imagines that the world starts with him and is in his hand". Magazines devote many pages to analysing the president's psychological make-up. The French blogosphere, too, is filled with caustic anti-Sarkozy commentary, mocking everything from his taste for Rolex watches to his overbearing posse of bodyguards and his tough policies on crime.

Some of this antipathy stems from genuine differences over policy. Mr Sarkozy was elected with a bold reform programme that broke with the consensual ideas of his fellow Gaullist predecessors, and many elements remain controversial. His attempt to shake up the centralised university system, for example, is fiercely contested by the left, which considers the whiff of competition to be an assault on the republican principle of standardised higher education for all.

Often, however, laying into Mr Sarkozy is a convenient way for the opposition to disguise its own failures. The Socialist Party is divided and drifting. Martine Aubry, its leader, is not a member of parliament; Ségolène Royal, who is not its leader, behaves as if she is. Mr Sarkozy's response to the recession is hard to criticise. He stepped in early to reassure the banks and put together a stimulus plan. More slippery still for the left, which is trying to accuse him of promoting savage free-market liberalism, he has targeted extra tax cuts and benefits on the low-paid and unemployed—with the help of Martin Hirsch, a left-wing anti-poverty specialist he recruited into government.

Above all, it is Mr Sarkozy's style and method of governing that prompts real passion. No president under the fifth republic has run so much directly from the Elysée Palace. Presidential advisers are as likely to decide policy as ministers. The prime minister's job has been downgraded to that of manager. Mr Sarkozy's network of business chums invites suspicions of cronyism. Moreover, by opening up his private life to public inspection, he has made his own behaviour, with all its quirks, a legitimate subject of debate in a way that would have been unthinkable in the past. He recently posted on Facebook a video of himself and two dogs dropping in on Carla Bruni, his wife.

Thanks to a hefty parliamentary majority, anti-Sarkozysm is unlikely to translate into legislative trouble. If anything, economic discontent in the street and at the factory gate remains the greater worry. Support among Mr Sarkozy's own electoral base remains solid. Indeed, the proliferation of parties on the left and centre means his UMP party may well come out top in the European election. The French may not much like their president. But they have yet to find anyone they like better.

**Poland's legacy of 1989**

# Still in the soup

May 28th 2009 | WARSAW
From The Economist print edition

**Political squabbles 20 years after the collapse of communism**

IN THE eyes of Poles, their country shattered communist rule in Europe, thus bringing down the Berlin Wall and freeing the nations of the Soviet empire. In Poland's telling, the heroes of the tale were the Polish pope, John Paul II, and the Solidarity trade union led by Lech Walesa, who founded the movement after a shipyard strike in Gdansk in 1980. Their influence, the story runs, forced the communist regime to concede nearly-free elections in June 1989. Poles voted overwhelmingly for non-communist candidates, inspiring other countries to cast off Soviet rule.

Many might quibble over the details of that account, but few would dispute the Poles' vital role in freeing Europe from totalitarian rule. Elmar Brok, a veteran German member of the European Parliament, says events in Poland were "fundamental" in bringing down the Berlin Wall. But two decades later, the message of Polish courage and success is mixed with a different one, of squabbles and economic difficulty. And the resulting rows are threatening to upset celebrations for the anniversary of the 1989 election.

The prime minister, Donald Tusk, himself from Gdansk, had wanted to invite leaders of neighbouring countries to a big party there. But he changed his mind after a protest by shipyard workers, during a meeting in Warsaw in April of Mr Tusk's centre-right European allies, turned violent. Police responded with tear-gas and batons. The workers threatened to spoil the party in Gdansk, so Mr Tusk moved it to Poland's southern university city, Cracow. He blames the opposition for using the union rally to make the government look bad.

Communist rulers mismanaged but also pampered Poland's three Baltic shipyards. Since 1989 the shipyards have failed to restructure and found it hard to compete. The Gdansk yard, indebted and ill-run, was sold in 2007 to ISD, a Ukrainian investor. But rows with the European Commission over state aid and restructuring plans make its future uncertain. The other two Polish yards have just been sold to a Caribbean-registered company, on unknown terms. Many shipyard workers have already lost their jobs. Others see unemployment looming. Union leaders have largely escaped the blame, though their inflexibility and self-importance is part of the reason for their members' plight.

Many Poles might have hoped that the importance of the anniversary would transcend such internal disputes. But the unity of 20 years ago is gone. Both Mr Tusk's party and its main rival claim to have inherited Solidarity's moral legacy. Mr Walesa, whose election to the presidency epitomised Poland's transition to democracy, has long since left the political mainstream. His views on the European Union have caused confusion. He has addressed rallies of Libertas, a Eurosceptic party that opposes the Lisbon treaty, only to declare that he supports the treaty.

Mr Walesa once said that imposing communism on Poland was like turning an aquarium into fish soup, and that the transition to democratic rule involved the rather harder task of turning fish soup into an aquarium. Although Poland's achievements then and since have been hugely impressive, the water is still cloudy.

**German history and the Stasi**

# The gunshot that hoaxed a generation

May 28th 2009 | BERLIN
From The Economist print edition

## The secret of a momentous death

AKG


**Was his killer a fascist or communist?**

THE death of Benno Ohnesorg stirred a whole movement of left-wing protest and violence. On June 2nd 1967 the newly wed student of literature joined a protest in West Berlin against the visiting shah of Iran. As he watched a commotion in the courtyard of a house into which police had chased some demonstrators, he was shot in the back of the head by a policeman, Karl-Heinz Kurras, who claimed he had been threatened by knife-wielding protesters.

This was a turning-point. In the eyes of many young Germans the state had unmasked itself as evil. Many joined what would become the 1968 student movement; some took up arms. “This fascist state wants to kill us all,” said Gudrun Ensslin, who went on to become a leader of the Red Army Faction terrorist group and died in prison in 1977.

Had she lived, she would be stunned to learn that Mr Kurras, now 81, had been a long-time agent of East Germany’s secret police, the Stasi. Historians trawling through the Stasi’s archives stumbled across 17 volumes chronicling Mr Kurras’s secret career. It began with an unsolicited visit to the Communist Party’s central committee in East Berlin in 1955 and prospered when he joined the state-security section of the West Berlin police. Under the codename “Otto Bohl” he rendered such services as tipping off the Stasi to espionage investigations and locating tunnels used by defectors from the east. Germans, who heard of Mr Kurras’s double identity this month, are wondering just how much of their history will have to be re-examined.

There is no evidence that the Stasi ordered him to kill Ohnesorg, though it was not displeased by the tumult that ensued. Would the students who embraced the martyr have blamed the West alone had they known that the bullet was fired by an agent of the East? Would fellow policemen have rallied around Mr Kurras, who was twice acquitted of manslaughter, had they known him to be a communist spy?

Despair over his exoneration helped drive Ensslin and others to violence. Till Meyer, once part of the violent June 2nd Movement and himself a former Stasi agent, told *Der Spiegel*, a magazine, that history need “not be rewritten a bit”. But if people like him had known who Mr Kurras really was, their extremism might have been tempered by uncertainty.

The revelation comes in the midst of an arcane but passionate argument about whether East Germany should be called a *Unrechtsstaat*, “a lawless state”. Politicians from the ex-communist Left Party reject the label, angering conservatives. Gesine Schwan, a candidate for the German presidency who lost to the incumbent, Horst Köhler, on May 23rd, heightened the row by saying she found the label too “vague”. To win, she would have needed support from the Left Party.

The unmasking of Mr Kurras does not entitle Germans to pin the blame for Ohnesorg’s killing on East Germany. But it does remind them that the Stasi was at the heart of the regime’s nastiness.

**Political turmoil in Georgia**

# The opposition locks itself up, and out

May 28th 2009 | TBILISI
From The Economist print edition

**Mikheil Saakashvili, an impetuous president, wins by keeping his cool**

AP

**They are burning themselves out**

GEORGIA'S political drama was inspired by a television reality show in which a pop singer imprisoned himself in a mock cell, from where he lambasted the government for betraying the country. Within a few weeks, on April 9th, the opposition set up hundreds of mock cells in the streets of central Tbilisi, blocking traffic and paralysing the work of parliament. The cells, they said, symbolised the police state run by Mikheil Saakashvili; he had to stand down.

Theatre is a form of life in Georgia. The stage was set for President Saakashvili, who fought a losing war with Russia in August last year, to break up the protests by force, as he had done in 2007. But for all of Russia's talk of "blood on the streets", the president did not play his appointed role as a hothead. Instead he let the opposition isolate itself. Apart from one violent clash on May 6th, when protesters attempted to storm a police station, the demonstrations have been peaceful.

For the most part, the police and even street cleaners were kept back. Within weeks, the centre of Tbilisi exuded the stench of litter, unwashed clothes and body odour. Many of the cells were empty, or were used by the homeless. For many Georgians, this was the smell of the dysfunctional, disorderly, lightless and unsafe city which Tbilisi had been five years earlier, before Mr Saakashvili came to power in the Rose Revolution.

Fear that Georgia might slip back into chaos, and recognition of Mr Saakashvili's role in building a functioning state, have deterred most Georgians from backing the opposition. Indeed, Mr Saakashvili's approval rating has risen by five points to 43% since the protests began, according to an opinion survey by Greenberg Quinlan Rosner, an American pollster. Many of Mr Saakashvili's more reasonable critics admit that the alternative is worse. Mr Saakashvili also earned credit for reaching out to the opposition, including offering to set up an opposition-led commission to draft a more balanced constitution and bringing forward local elections.

On May 26th the opposition packed at least 60,000 supporters into a football stadium in Tbilisi. But the Georgian Church told its leaders to be more flexible, giving its moderate members, such as Irakly Alasania, a former ambassador to the United Nations, a perfect opportunity to withdraw from the embarrassing street theatre. "We need to offer more than demand Mr Saakashvili's resignation," he says.

The radical wing of the opposition, led by Nino Burjanadze, a former speaker of parliament, went on to block Tbilisi's railway. Ms Burjanadze, who has been one of the driving forces and financiers of the protests, is one of the country's least popular politicians. Ordinary Georgians associate her with the

Soviet-era *nomenklatura*. (Embarrassingly, she has demanded that Mr Saakashvili should give her government-owned property for a token price.)

The sorry state of the opposition should not obscure Mr Saakashvili's flaws. Georgia's efficient police force may not be corrupt, but it is not independent, and television is less free than it was. Mr Alasania says Mr Saakashvili has concentrated too much power in his hands and relies on a small circle of insiders, rather than on institutions, to make crucial decisions; that is why he rashly took the country into war with Russia.

Georgia's future will be determined as much by external factors as by domestic politics. On May 5th the army quelled a military mutiny. Officials say it reveals a deep-rooted fear that Georgia will remain a target for attack for as long as Mr Saakashvili stays in power. Part of the Russian army is said to be itching to finish the job: to demilitarise Georgia and “hang Mr Saakashvili by the balls”, as Russia's prime minister, Vladimir Putin, once told President Nicolas Sarkozy of France. (Dmitry Medvedev, Russia's president, says he will never talk to Mr Saakashvili.)

Russia is preparing to hold a large military exercise near the conflict zone. Such an exercise was the precursor to last summer's fighting. Nine months after the war, Russian troops have not fully withdrawn to their pre-war positions, as agreed under an internationally-negotiated truce. Instead, it is holding on to some of the territories it captured. One such area is the town of Akhalgori, which puts the capital, Tbilisi, within easy reach of the Russian forces. Russia has also increased its military presence in South Ossetia and Abkhazia, the two breakaway regions recognised by Russia as independent.

Russia's precise military strength is hard to gauge. Monitors from the European Union can patrol only areas held by Georgia, implicitly accepting the new frontier, now guarded by Russia. Moreover, Russia has all but thwarted the Georgian mission of the Organisation for Security and Co-operation in Europe (OSCE), which has a mandate to monitor South Ossetia. That runs out on June 30th, and Russia, as one of the OSCE's 56 members, refuses to renew it, arguing that South Ossetia is now an independent country. So far the West has turned a blind eye.

Russia may not resort to another war. In any event, Russia knows it will not be able to install a pro-Russian government in Georgia. But with or without Mr Saakashvili, a dysfunctional and unstable Georgia that is a burden to the West would suit the Kremlin's interests.

**Charlemagne**

# The worst of times, the best of times

May 28th 2009
From The Economist print edition

**Why some European politicians face public wrath, while others still enjoy the high life**

Illustration by Peter Schrank


IN BRITAIN it was the duck-house. For many, this floating pavilion, claimed on parliamentary expenses by a Conservative knight of the shires, revealed something rotten about the House of Commons. In Spain earlier this year, hostile headlines centred on a €480,000 ($670,000) armoured Audi bought by the president of the western region of Galicia (who already had three other limousines). In Belgium's depressed French-speaking region of Wallonia, it was a taxpayer-funded jaunt that caused something in voters to snap: an official "working visit" to America by members of the Walloon parliament. Its highlights included tours of the Grand Canyon, Napa Valley vineyards and Alcatraz prison; the 11-day trip in April involved just four days of meetings, including one with experts on farming in arid regions, a joke not appreciated back in rain-lashed Belgium. Further outrage followed this month when it emerged that a Walloon regional minister, Didier Donfut, was the owner of a consultancy firm that was paid more than €140,000 a year to advise local public bodies.

In each case, the politicians involved denied wrongdoing. Yet they made voters angry enough to threaten or end their careers. Britain's "duck-house MP" is standing down; Galicia's president lost elections in March; the Walloon parliament rewrote its rules on travel in a panic; and Mr Donfut resigned. Wallonia's ruling Socialist party faces a pasting in regional elections next month.

Certain things link all these cases of voter rage. There is a recession on. It can be fatal for politicians, moreover, when their errors are colourful or smack of satire—just ask Douglas Hogg, a Tory grandee who announced he would not stand for re-election after it emerged that he had billed Parliament for, among other things, the cleaning of his moat.

It is also dangerous when scandals perfectly capture well-known flaws. Spain's regional leaders are baronial figures, whose slightest movement involves wailing sirens and limousines. Belgium is infested with politicians (it has six parliaments for a country of 10m people). That is because public money is used to buy peace in Belgium, whose Dutch- and French-speaking halves increasingly loathe each other. As a result, endless obscure ministers inhabit a world of obscure public bodies, run by political hacks and serviced by a parasitic class of consultants, lawyers and the like—often members of their families.

All this said, there is an unanswered question. Privileged politicians are found all over Europe. Yet they have become an issue only in some countries. Why is that? In France's National Assembly, after all,

deputies receive, on top of their salaries, a yearly expenses allowance of €70,044 tax-free, with no receipts or questions asked. Nobody seems very angry about this. True, the outgoing president of the French Senate was forced by public opinion last year to leave his official residence, after he tried to hang on to it. But the tumbrils are hardly circling. The new Senate boss, Gérard Larcher, escaped with only mild teasing when he recently declared himself an historic reformer, on the ground that he paid for his own dry cleaning. It is not just France. A bestselling book in 2007, “La Casta”, or “The Caste”, calculated that Italy’s parliament spends ten times more on itself than its Spanish equivalent, thanks to countless perks, including individual tennis lessons for members.

More broadly, citizens in the European Union know all about outrageous perks, because they all elect members of the European Parliament (MEPs). Some excesses have been abolished, such as flat-rate travel expenses often worth five times the actual cost of an air ticket. But even under cleaned-up rules that will take effect next month, the more shameless members may still take home €200,000 a year, says Chris Davies, a British Liberal Democrat MEP who has campaigned for reform.

## Rich pickings at the European Parliament

The new system offers a €92,000 annual salary and a generous “non-contributory” pension funded wholly by taxpayers. In addition, members will get a €50,424 annual allowance to run a constituency office (though some don’t have one), attendance allowances of €298 a day, and top-up travel expenses worth hundreds of euros a week: no receipts are needed. If that were not enough, in March this year almost 70% of MEPs voted to keep future expenses secret, though some British, Dutch and Nordic parties have promised that their MEPs will publish accounts.

Voters across Europe are going to the polls on June 4th-7th to elect a new European Parliament. Why are so few of them angry with that body? A partial answer might be that some countries are more resigned to corruption than others. In Italy and Spain, notes Victor Lapuente, an expert on government at Sweden’s Gothenburg University, mayors involved in corruption cases are often re-elected. That would be unthinkable in Finland, say.

Yet even in Britain, where the excesses at Westminster are provoking outrage, the correlation between public anger and corruption is imperfect. Opinion polls show a resurgence of support for a Eurosceptic outfit, the United Kingdom Independence Party. Of the group’s 12 MEPs elected at the last Euro-election, one was subsequently jailed for fraud and another has been charged with false accounting and money laundering (which he denies).

A last theory, then. What is going on is a revolt against those whom voters blame most for the economic crisis. In Britain anger is directed mainly at the big parties. In France and Germany, more voters blame capitalism and hope the state will save the day; that might explain why anger there is directed at high-paid bankers and executives rather than at high-living politicians. The European Parliament does not come out of this theory well, of course. If Europe’s voters are indifferent to the excesses of MEPs, it is because nobody thinks they are in charge of very much at all.

**Britain's relationship with Europe**

# Out of sight, out of mind

May 28th 2009
From The Economist print edition

**Europe is invisible in the European election campaign. It shouldn't be**

EUROPE helped bring down two of Britain's recent prime ministers, Margaret Thatcher and John Major. But at least they were casualties of weighty conflicts over their country's future in the European Union (EU). On June 4th Gordon Brown may be mortally wounded by nothing grander than election results for the European Parliament. A poor showing for the Labour Party could be used by some of the prime minister's colleagues, already glum about his chances of leading them to victory at the general election likely to be held next year, as the cue for a putsch.

In fact Labour will struggle to do much worse than it did in 2004 (see article). But judging by the campaigns that political parties are waging, the European elections in Britain will have even less to do with Europe than in most EU member countries. Contrite plans to reform British politics in the wake of the parliamentary expenses scandal that broke earlier this month have flowed from Labour, the Conservatives and the Liberal Democrats (see article). Europe has rated only perfunctory mention. Mr Brown called for a European economic-growth strategy on May 27th, dutifully chiding the Tories for their supposed isolationism along the way. Even smaller outfits for whom Euroscepticism is a defining creed, such as the UK Independence Party (UKIP) and the far-right British National Party (BNP), have run more on an anti-politics than an anti-EU platform.

Some of this indifference is easy to explain. The tide of European integration has slowed in recent years, leaving Britain with less to get worked up about. (Renewed talk of joining the single currency several months ago, as sterling was sinking, has fizzled out.) Tony Blair was constantly talking up the EU; his successor as prime minister has rarely shown the same zeal, and is anyway preoccupied with fighting a recession. And it is not as if voter interest has fallen to worrying levels. Turnout is likely to be about as high as in the European elections of 2004, and much higher than in 1999.

Explaining Europe's low profile in the European election campaign is one thing; excusing it is another. In all the usual ways—as a trading partner, source of legislation and growing geopolitical presence—the EU remains important for any member state. But there are reasons for the British to take it more seriously than most.

For one, Britain's likely next government faces a crisis over the EU's Lisbon treaty, which Parliament

ratified last year. Opposed to what they see as a repackaged version of the EU constitution rejected by French and Dutch voters in 2005, the Tories have promised a referendum on the treaty if it is not in force by the time they come to power. If it were then voted down, as is likely, they would withdraw Britain's ratification—to the certain outrage of the rest of the EU. If, on the other hand, the treaty has been ratified by all EU countries (Ireland will hold a referendum in October, and three other countries have yet to complete the treaty process), the Tories have pledged not to "let matters rest there".

The awkward ambiguity of those words attests to the dilemma facing David Cameron, the Tory leader: swallow the treaty and alienate his party, or scupper it and infuriate the EU (as well as Barack Obama, who is rumoured to be exasperated by Tory hostility to the union). Britain's very membership of the EU could come into question.

On the campaign trail, however, Mr Cameron has escaped the scrutiny that his line on the treaty merits. More eyes have been trained on his decision to shift his MEPs from a centre-right to a farther-right, Eurosceptic caucus in the European Parliament. But deflecting attention from a problem is not the same as solving it. Unless the convoluted strategies for finessing the treaty dilemma now being kicked around in Tory circles come to something, a showdown with the party or the continent seems likely for Mr Cameron.

There is another reason why British politicians should grapple more thoughtfully with the issue of Europe. Their country's role in the EU as champion of liberal economic reform needs work. The plausibility of the Anglo-Saxon model, with its reliance on financial services and light-touch regulation, has been diminished by the credit crisis and recession. There is still a job to be done defending open and competitive markets from the protectionist pressures that are emerging across the EU, not just in *dirigiste* France. Important struggles lie ahead over financial regulation, social legislation and more.

But Britain cannot easily reprise its Blair-era identity as the freewheeling California of Europe. It needs non-economic causes to champion as well. A report by the Royal Institute of International Affairs, a think-tank, says that Britain should push for further enlargement and closer collaboration in security-related areas such as home affairs and defence. Though the Tories think NATO sacrosanct, the Americans are increasingly relaxed about military co-operation within Europe.

Public opinion in Britain, meanwhile, seems to be growing more Eurosceptic (see article). Campaigning to push power to Brussels, so that decision-making becomes even more remote from ordinary voters, seems foolhardy in the current anti-political climate. This coolness toward Europe suits the Tories most, free as they now are of the splits on the subject that did for the Thatcher and Major administrations.

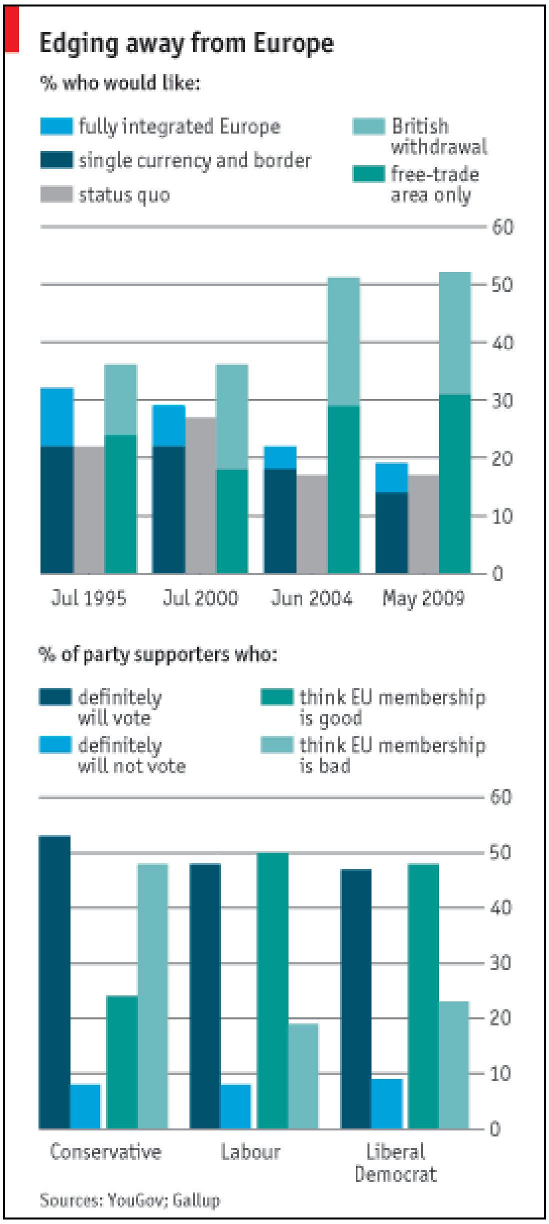
Party leaders' unblinking focus on political reform may be warranted: voters' fury at MPs caught with their hands in the public till is intense. But the coming years hold challenges for Britain in its relations with the EU. It is hard to believe that its politicians, especially the Tories, will not come to regret their failure to think these through while they had the chance.

**The march of Euroscepticism**

# More want less

May 28th 2009
From The Economist print edition

**Ever closer union, ever greater doubts**




AWARE that the EU is seen as distant and imperious, its officials have been trying to persuade Britons to vote in the elections for the European Parliament next week. A series of Euro-posters (some about tricky subjects like energy, others about more banal things such as product packaging) have popped up here and there. The Eurocrats will be pleased with predictions that turnout will be about as high as in the previous European ballot in 2004, as vote-inducing outrage over MPs' expenses cancels out vote-reducing lack of interest in Europe. They may be less pleased with the outcome.

Polling commissioned from YouGov by *The Economist* suggests that Britain is gradually becoming a more Eurosceptic place. Over the past quarter-century the proportion of people who think Britain's membership of the EU is a good thing has fallen from 43% to 31% (with a spike in 1990 after sterling's ill-fated entry into the Exchange Rate Mechanism). The share of those who think it a bad thing has risen from 30% to 37%. Support for greater integration has dropped, from one in three in 1995 to one in five today (see

chart). Those within that group who favour a fully-fledged European government make up only 5% of the total, down from 10% in 1995. Over the same period support for loosening Britain's ties to the EU has risen from 36% to 51%, and those who want Britain to withdraw from it have almost doubled, from 12% to 21%.

Attitudes split roughly along party lines. Conservative voters are the most Eurosceptic (as well as, by a small margin, the most likely to vote). Liberal Democrat supporters are, surprisingly, slightly less keen on Europe than their Labour counterparts, even though the Lib Dems are officially the most Euro-friendly party.

There is also a correlation with age, with older voters leerier of Brussels than their younger compatriots. One explanation is that a cohort of greybeards have fond memories of life with a less powerful EU. Another, says Peter Kellner, head of YouGov, is that, like conservatism, Euroscepticism may come with age.

Tense times as elections loom

# Testing the water

May 28th 2009
From The Economist print edition

**Local contests say more about voters' national mood than the European ones**

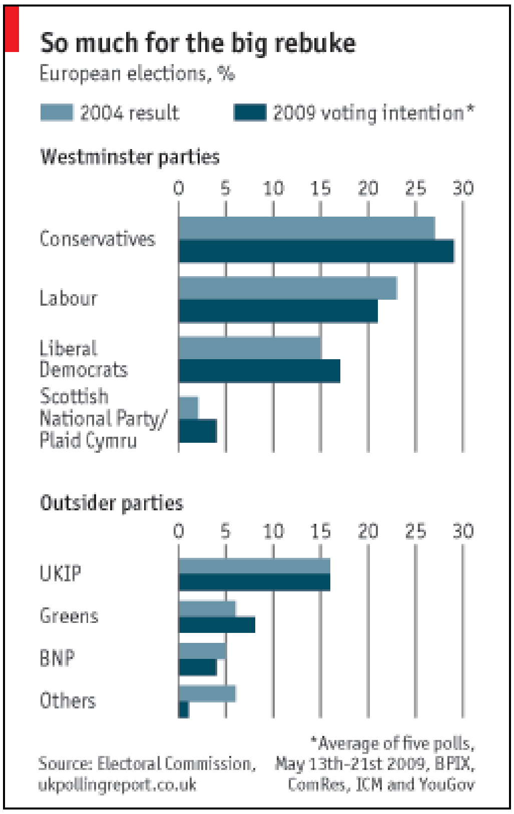
THE explosive revelations about MPs' expenses have left many a politician's nerves in tatters. What retribution will voters exact after finding out that they have been footing MPs' bills for everything from duck islands to tax advice? The European and local elections due to take place on June 4th will provide some clues.

Britain, like the rest of Europe, will be electing its representatives to the European Parliament for the next five years. Voters in some parts of England will be choosing new county councillors too.

MPs' biggest concern is that voters are so disgusted by the expenses scandal that they will abandon the ballot box entirely. European elections struggle to generate excitement at the best of times. In the last contest, in 2004, only 38% of those eligible cast a vote; in 1999 just 23% of them did. In fact, though polls taken in the wake of the expenses drama suggest that people are less willing than before to vote in a Westminster contest, interest in European balloting is holding up.

A more obvious way for voters to express their disenchantment with the political status quo is to vote for one of the "outsider" parties not currently represented at Westminster. As elections to the European Parliament, unlike those to the House of Commons, are conducted under a system of proportional representation, voting for outsiders can bring them a real reward.

If the Westminster parties do get a kicking next week, this will be nothing new. As the chart shows, one in three of those who bothered to vote in 2004 backed an outsider. Particularly successful were the United Kingdom Independence Party (UKIP), whose policy of withdrawal from the EU found and finds a ready echo among a distinctly Eurosceptic British public. Polls so far suggest that the level of support for outsider parties overall will be much as it was in 2004.



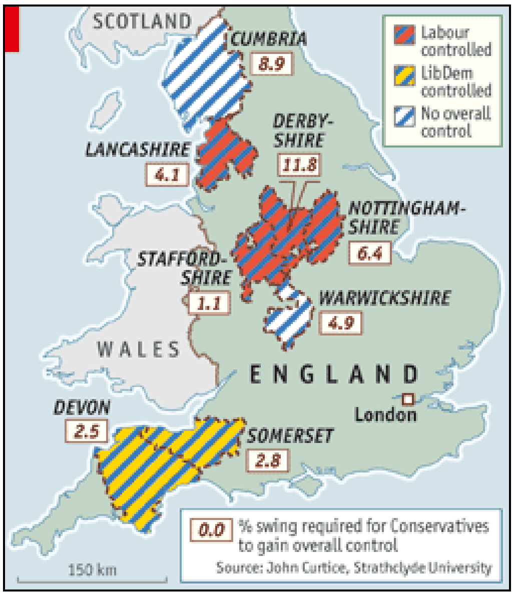

UKIP again looks set to be the most successful. Much of its support comes from those who would vote Conservative in a Commons election. David Cameron, the Tory leader, has demanded that Britain hold a referendum before ratifying the Lisbon treaty increasing European integration, and promised to withdraw Tory MEPs from the pro-EU European People's Party grouping at Strasbourg. This has not been enough to stem the UKIP tide: support for the Tories in the Euro-elections is running ten percentage points below the party's current standing in Westminster polls.

Labour, meanwhile, was fretting about the damage it might suffer at the hands of the far-right British National Party (BNP) long before the expenses scandal broke. During the past decade or so the anti-immigration BNP has achieved notable electoral success among older and less educated white voters living in proximity to minority-ethnic, and particularly Muslim, communities. These are voters who might otherwise be expected to support Labour.

Polls so far suggest that the BNP will do no better than the 5% it won four years ago, too little to secure a Strasbourg seat. A slim two-point increase in its vote, though, would be enough for a breakthrough. Either way, expectations that Labour will suffer serious losses seem wide of the mark. After all, the party won only 23% of the vote five years ago.

The Liberal Democrats, for their part, might hope to do well in the European elections. Relatively few of their MPs have been caught in serious expenses-fiddling, and as the third party at Westminster they could expect to benefit from a backlash against the system. But some of the party's middle-class voters regard the Euro-elections as a chance to express their environmental concerns by backing the Green Party. The Greens may well retain their existing two MEPs, and the Lib Dems struggle to beat UKIP into third place.

## Back in the shires




Local elections, in contrast, are often fertile ground for the Lib Dems, who long ago perfected the art of pavement politics. Next week's local contests, held under the first-past-the-post system, are especially important this year. Nearly all the seats up for grabs were previously contested on the same day as the last Westminster election, in 2005. They will thus provide a direct measure of the rise and fall in the party's fortunes since Labour won its historic third term.

Labour could well suffer serious losses. Most of this year's local elections are taking place in rural England. In 2005, in what was already a bad result for the party, Labour kept majority control in only four counties: Derbyshire, Lancashire, Nottinghamshire and Staffordshire. It will lose all four if local voting is in line with the 9% national swing from Labour to the Tories that Westminster polls are now picking up. The last time Labour lost these councils was in 1977, two years before it was ousted from power nationally.

But Mr Cameron will hope to do more than deny Labour its quartet. He will want to capture enough local seats so that the Tories have overall control themselves. The map shows just how a big a swing he is likely to need to achieve that in each county. Two other councils where no party currently has overall control, Cumbria and Warwickshire, are in his sights too, as are two counties in the south-west where the Lib Dems now have a tenuous hold.

Perhaps by the end of next week all eight councils will be painted blue. If they are, the odds on a Conservative victory when MPs eventually face the voters themselves will be very short indeed.

**Oxford poets at war**

# Natural selection

May 28th 2009
From The Economist print edition

**Academic squabbles really are the bitterest**

DONS get their knickers in a knot so easily because the stakes they are playing for are pitifully low, the theory goes. That may be why Oxford University's professorial seat in poetry, paying just £6,901 ($11,000) a year, has inspired a feud frosty enough to turn sherry to ice in common rooms this week.

Every five years the university's academic staff, and everyone who holds an Oxford degree, may vote to fill the 301-year-old post. Anyone can stand. It is the stellar list of past occupants, including Matthew Arnold, W.H. Auden and Robert Graves, that gives the job its cachet, not the meagre stipend.

The plotting this year was lunatic. Anonymous letters went to a hundred Oxford movers-and-shakers, detailing claims of sexual harassment made in 1982 against Derek Walcott, a West Indian poet fancied to win. He dropped out, leaving Arvind Mehrotra, of Allahabad University, and Ruth Padel, a great-great-granddaughter of Charles Darwin, in the race. Both condemned the smear campaign. On May 16th Ms Padel became the first woman to win the job, though a tenth of the ballots were spoiled.

Eight days later it emerged that Ms Padel had in fact helped to spread the story of the sex scandal by e-mailing journalists with recommended reading on it. (She claims no link to the anonymous letters.) She resigned the post on May 25th after it became clear that a motion against her was being drafted by excited dons. She has apologised, sort of, for sending e-mails that could have been "misconstrued as being against [Walcott]"—as if briefing reporters about his alleged sexual misdemeanours was not intended to affect his chances.

A fresh election is expected next term. Mr Walcott has said he will not run again; the sounds from behind Mr Mehrotra's beard are so far inconclusive. Whoever stands, Oxford might want to look at ways of increasing the turnout. This year, out of more than 4,000 academic staff and 150,000 graduates, only 477 people bothered to vote.

It may be hard to prise dons away from the important business of writing acid e-mails to each other. But more graduates might vote if they could do so by post. At a time when the university is spending millions on tea parties and the like to cultivate alumni donors, it would be a cheap way to maintain links—and would make nobbling voters harder too.

**Green shoots in garden centres**

# Blooms in the bust

May 28th 2009
From The Economist print edition

**The recession has sent Britons back to the land**

Alamy

LIKE all quintessentially British things, gardening is a pastime that has long been in decline. From a high point of £5 billion in 2001, spending on plants, tools and garden furniture has fallen every year since then, to around £3 billion in 2008. The arrival of economic recession only deepened the gloom: to credit-crunched consumers, shrubs and hanging baskets seemed obvious candidates for cuts.

Yet the latest figures from the Horticultural Trades Association (HTA) suggest a bumper year for garden-related expenditure is in the making. Sales volumes were up by 21% in March and 28% in April compared with the same months a year earlier. This was not the result of deep discounting, a strategy that many other retailers have been adopting. The value of garden goods sold was 37% higher in March and 42% higher in April than a year earlier, whereas the value of all sales had increased by just 3% in April. Datamonitor, a market-research firm, reckons that gardening will continue to outperform the rest of retailing for at least the next two years.

Much of the good news is due to the weather, admits Tim Briercliffe, the HTA's director of business development. Last year the vital spring months were damp and miserable; this year sunshine (and weathermen's prediction of a hot summer) has boosted custom. But the economic downturn itself has turned out to be as much a blessing as a curse. Gardening may be a luxury, argues Mr Briercliffe, but it competes with other, more expensive luxuries. "People who might have otherwise booked a city break to Prague are staying at home and making the best of what they have," he maintains. According to Ipsos MORI, a pollster, three-quarters of people plan to spend at least as much on their garden this year as last.

Economic hardship has created a new breed of gardener too. Partly, that reflects people making the most of their enforced leisure: "We get some unemployed City types who are just filling time while looking for another job," admits a garden-centre worker near the London commuter town of Guildford. But there are more positive developments. Much of the growth in garden spending has come from the under-35s, not traditionally a green-fingered demographic. One explanation is that environmentalism and thriftiness have made growing vegetables trendy, an idea that is supported by the growing shortage of allotments.

But there is more to it than pleasant weather and belt-tightening. The HTA detects deeper, and darker, changes in the national psyche. Citing research from the Future Foundation, a prognosticatory consultancy, it reckons that people are spending more time in their homes, fortifying them into havens from an unwelcoming world haunted by crime, bureaucracy and rising unemployment. The longer the downturn persists, the greener the grass may grow.

**Nurturing small businesses**

# Battery farm

May 28th 2009 | EASTLEIGH
From The Economist print edition

## A haven of hopeful endeavour

Illustration by David Simonds


THOUGH British carmakers may face further shrinkage as General Motors abandons its Vauxhall plants at Luton and Ellesmere Port to sale or closure, there is life in the undergrowth where industrial monsters have fallen. Take Eastleigh in Hampshire, whose railway works once sustained the town. Pirelli also closed a cable factory there in 2002, and Ford has just cut 500 jobs and suspended production of vans at nearby Swaythling.

Eastleigh is hardly a tourist town—a dour bronze railwayman is its main public monument—but it has a brilliant formula for incubating new businesses. Wessex House is a 40,000-square-foot redbrick building with 100 offices housing about 70 small firms. Among them are Happy's Circus, run by Happy the Clown, Finblade, which makes mobile video games, and builders, architects and other providers of services based on clever ideas. Outstanding Results, a debt collector, has been busy chasing late payments, some of them on behalf of fellow tenants.

Wessex House is owned and run by Eastleigh Borough Council and makes enough money to pay its way. Firms can rent anything from a one-person office to a whole floor. Some have grown, shrunk and expanded again. A former tenant—Murphx, which provides IT services—now lives next door: the Bentley and Aston Martin in the car park tell the story.

Some of these businesses are growing in the teeth of recession. Tucasi, a brainwave of three school governors, is selling software packages to schools, to manage the money parents pay for school dinners, outings and so on. So far Tucasi has collared 1,300 primary and secondary schools. Business has doubled in a year, says Peter Redding, a director. He could easily treble it but "that would bring its own risks," he says.

Rob Poole at Blacks, an estate agent, has found a niche between rivals on the internet and high-street firms. He operates from Wessex House, without a shop-window, and charges half the high-street fee. This is the model of the future, he says, insisting that business is "brisk".

Are such motley enterprises a barometer of British business in recession? The Confederation of British Industry's May survey on the service sector points to an "outbreak of optimism" in the property world and a similar uptick in almost every consumer branch except travel. But expectations of new orders and business expansion in fact show only a marginal improvement on the dire mood that has prevailed since November. The Wessex House experience reflects that. Martin Brand, at Outstanding Results, has seen a huge increase in work but, as times are tough, "not necessarily an increase in what is collectable".

Phil Davis, a building contractor, has no work at all, despite cutting his margins by ten percentage points. He and his wife are considering shifting their office to their home. The ability to move in and out of Wessex House with only a month's notice is its major attraction for uncertain businesses. "Several tenants have gone back to work from home," says Sandra Giles, who manages the business centre. Others have negotiated lower rents while slashing their own salaries too. Finblade, whose video-game team have been there in various guises since 2001, was forced to cut its staff savagely last year, from 14 to six, because of financial problems with customers that its bank was reluctant to ease. For all the human cost, "in a strange way it has left us in a better position as the market picks up," says Fergus McNeill, the chief executive.

Other firms in the rabbit warren are apparently recession-proof: Solent International, which fits out yachts

abroad for the super-rich; Alkoomi, a consultancy which imparts “safety leadership” at construction sites such as Heathrow’s Terminal 5 and Britain’s Olympic Village; Kevin Walls, an architect upgrading hospitals for the National Health Service.

The veterans of Wessex House are survivors but not shooting stars. They are service providers who live on low overheads, exploit niches and rely on smart staff. That is hardly a cross-section of the British *Mittelstand*. Nor is Eastleigh a post-industrial wasteland like some of north-eastern England. The railway works never died completely: in 2006 Knights Rail Services took over the premises to overhaul locomotives. But Eastleigh Council also plans to develop 130 hectares of the site, to encourage new businesses. Wessex House, it seems, has something to teach.

Presbyterians and gay ministers

# Swinging both ways

May 28th 2009 | EDINBURGH
From The Economist print edition

**Clever boxing has saved the Church of Scotland from schism for the moment**

PA

When hand-wringing is not enough

THERE is something about gender and sexuality that seems to split asunder one church after another these days. Last year the Church of England and the worldwide Anglican Communion failed to resolve profound differences over whether gays and women should be made bishops. This month the Catholic church in Ireland has been pilloried for years of mistreatment, including sexual abuse, of children in its care. This week, less dramatically, it was only some deft manoeuvring that kept the Church of Scotland in one piece.

The Kirk's general assembly, the annual gathering of ministers and lay folk who dictate policy for the church as a whole, decided by 326 votes to 267 that an Aberdeen congregation had broken no rules in choosing the Rev Scott Rennie, a divorced father who lives with his male partner, to be their pastor. But it also said that no more gays should be ordained for two years, while a church commission ponders whether the practice ought in fact to be allowed. Mr Rennie claims that there are already "tens" of ministers who dare not admit openly to being gay.

Some think this convoluted outcome may presage a breakthrough for sexual tolerance in the Presbyterian church. The Scottish Kirk, founded in 1560 by John Knox, is regarded by many, especially among the Americans, Africans and Caribbeans who trace their Christian origins to emigrant Scottish clerics, as the mother church of this brand of reformed Christianity. With a few exceptions, such as the United Church of Canada, most Presbyterian churches officially regard gays as sinners who need re-education. A vote for tolerance by the Kirk's general assembly could start to change that view.

But politics, rather than high theology, produced this week's decision. Church higher-ups were anxious to avoid discussing a demand launched by a presbytery in the Highlands, where biblical injunctions against sodomy tend to be taken literally, that all non-heterosexuals be banned from the ministry. And the outcome has greatly displeased the Church of Scotland's sizeable evangelical and traditionalist wing, whose ministers have resorted not to the Bible but to Mammon in carrying on their battle against the liberals. They are threatening to withhold their congregations' collections from the church's central funds, claiming to have given a big slice of the £42m that the church's 472,000 members contributed in 2008. They sound most unlikely to be pacified if the commission comes up with a clever theological way of admitting gays to the Kirk's ministry.

That would be unfortunate. Many historians argue that the rise of Protestantism and its questioning of centrally imposed orthodoxies paved the way for the Scottish Enlightenment and thinkers such as David Hume and Adam Smith. A different history now looks likely to repeat itself: more division in a church whose past is dominated by secession.

**Bagehot**

# The baby with the moat water

May 28th 2009
From The Economist print edition

**The sudden frenzy for constitutional reform, and what might come of it**

Illustration by Steve O'Brien

“HE’S the re-form candidate, daddy,” Junior O’Daniel says of his father’s challenger for the governorship of Mississippi in the film “O Brother, Where Art Thou?”. “A lot of people like that re-form. Maybe we should get us some.” Britain’s political parties all seem to be thinking much the same thing.

The expenses scandal has ignited a broader, competitive debate about parliamentary and constitutional reform. As is always the case with constitutional debates, this one combines the noblest motives, or their avowal, with self-interest: a need to seem attuned to public contempt for politics, and an opportunistic bid to push pet ambitions while the mood seems propitious.

Consider the big speech given by David Cameron, the leader of the Conservatives, on May 26th. Mr Cameron argued for a cut in the number of MPs—an economy which, because of the pro-Labour way parliamentary constituencies are now organised, would benefit the Tories. He roped in assorted policies that the Tories have long been flogging under their clunky slogan of “the post-bureaucratic age”. So, for example, holding a referendum on the Lisbon treaty, abolishing quangos, and the Tories’ plans for local government and school reform all featured beneath the rubric of redistributing power. That is not to deny the virtue of some of Mr Cameron’s ideas, such as more directly elected mayors and open primaries for picking parliamentary candidates.

Meanwhile Nick Clegg, the leader of the Liberal Democrats, called for a “total reinvention of British politics”, which he optimistically claims can be achieved in 100 days. He wants voters to have a California-style right of recall over MPs; to replace the House of Lords with an elected senate; to tighten the rules on party funding; and, as ever, to replace the first-past-the post method used in Westminster elections with a more proportional system (which would principally benefit the Lib Dems).

In that last cause he is joined by Alan Johnson, the health secretary and the man likeliest to replace Gordon Brown should Labour ditch him after next week’s local and European elections. “What is Johnsonism?”, some sceptics have asked. Mr Johnson supplied part of the answer in an article in the *Times*: he advocated a referendum on adopting the complex voting system that was recommended by an inquiry in 1998, then shelved by Tony Blair.

Other Labour figures weighed in too. Ed Miliband, the energy secretary, wants to do away with

Parliament’s arcane vocabulary and costumes. Jack Straw, the justice secretary, sounded receptive to the recall scheme. For his part Mr Brown pointed to the (few) executive powers he is already handing to Parliament and pledged to go further. “There is no option I will not consider”, he wrote in the *Independent*, “if it redistributes power.”

## No man is a duck island

On the face of it, much of this is a weirdly tangential response to the expenses debacle. Think about it: the prime minister is criticised for his leaden response to expenses-gate; seizing the moment, the man tipped to succeed him urges a switch to an abstruse electoral system. Mr Cameron and others maintain that alienation between rulers and ruled is older and deeper than the outrage provoked by tax-funded duck islands. True; but it is extremely doubtful that it will be salved by the introduction of the D’Hondt technique. “A lot of people like that re-form”, but mostly of a less recondite kind. This sort of talk looks a bit like throwing the constitutional baby out with the moat water; it risks making Westminster seem yet more remote and introverted.

In any case, very few of these proposals will be enacted. Voting reform, for example, always seems most attractive to politicians when they are about to lose elections under the existing arrangements—which is also when they are least able to implement it (and some senior ministers oppose Mr Johnson’s suggestion anyway). Many politicians know their constitutional thinking is wishful. To some extent their chatter is a collective effort to divert attention from their expenses-induced shame. Nevertheless, there are two easy changes that could and should be made.

One is to transfer still more power from the executive to Parliament. Granting extra time to private members’ bills; letting MPs pick the members of select committees without meddling by the whips; allowing more free votes: none of this requires legislation. Mr Straw and Harriet Harman, the leader of the House of Commons, are due to convene talks to discuss such measures, which Mr Cameron and Mr Clegg say they support. Boosting MPs’ freedom and remit might seem another strange response to their misdemeanours. But it is necessary and overdue.

The other good idea around which opinion is coalescing is a switch to fixed-term parliaments. Mr Brown’s premiership has been one long parable of the perils—for both the country and the government—of letting prime ministers pick the date of a general election. Even with the necessary get-out clauses, to take account of a government losing its majority and other debilitations, such a move would be relatively simple. Mr Cameron sounds amenable; Mr Clegg is committed.

In fact, Labour has a rich record of constitutional reform. The trouble is that its upheavals—in the Lords, via devolution and so on—were implemented long ago and cack-handedly. Attention wandered, the job was left incomplete and, as the original Bagehot said of earlier constitutional evolutions, “the hesitating line of a half-drawn battle was left to stand for a perpetual limit.” It is now too late for Mr Brown to portray himself as an anti-establishment hero: as Pappy O’Daniel puts it in the film, “How we gonna run re-form when we’re the damn incumbent?” But Mr Brown could nobly sacrifice some authority in a way that prime ministers tend to avoid, however keen they sound in opposition, as Mr Cameron does now. Go on, prime minister: call his bluff.

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Economist.com/blogs/bagehot

**Amnesty International**

# Taking on the sins of the world

May 28th 2009
From The Economist print edition

**No state or system has a monopoly on curbing liberty, as Amnesty (perhaps a tad grudgingly) agrees**

Alamy


FOR an organisation that has tried to broaden the definition of human rights, Amnesty International has a lot to say about violations of the old-fashioned sort. Its latest report on the state of civil liberties round the world is a ghastly tale of torture, state terror, the suppression of free speech and the curtailing of due process, under regimes of every ideological stripe.

With its cautious, empirical approach to researching abuse, "The State of the World's Human Rights" is a tome with moral power—as useful a work of reference as the American State Department's annual reports (on human rights and more specific matters like human trafficking and religious freedom) and those of fellow NGOs like Freedom House and Human Rights Watch.

Just as Freedom House (committed to the belief that the United States is, or at least can be, a benign power) is sometimes chided for overstressing the faults of America's foes, Amnesty has in recent years had the opposite aura: it has often seemed to share a rhetorical platform with the opponents of capitalism and globalisation, not all of them very liberal.

But to its credit, the 2009 report pulls few punches in documenting the misdeeds of regimes that use the rhetoric of revolutionary socialism or "anti-imperial" rage. For example, it finds that last year China's authorities "intensified their use of administrative forms of detention which allowed police to incarcerate individuals without trial." Far from ushering in a happier, freer China, the Olympic games had brought "heightened repression throughout the country" with tighter state control over human-rights activists, religious groups, lawyers and journalists.

It devotes one of its longer entries to the woes of Iran, where at least 346 executions were carried out in 2008, and 133 juvenile offenders were at risk of being put to death. (Amnesty opposes the death penalty.) Other punishments included flogging and amputation; public stoning was supposedly stopped as a form of execution last August, but two men died by that method in December.

In Iran and many other countries, Amnesty detected a retreat in women's rights, often in the name of religion. Dozens of Iranian women's rights campaigners were detained and interrogated. Some were tried; up to ten were sentenced to prison terms and at least two to flogging.

It is not just Muslim theocracies that Amnesty blames for maltreating women or denying their "reproductive" rights. (The organisation has since 2007 added abortion rights to its list of core concerns, a stance the Roman Catholic church has deplored.) Even Finland—often seen as a model of sexual equality—gets a scolding. Less than 10% of rapes in that country are reported to the police, and only one in seven of those cases leads to a conviction.

With regard to its home country, Britain, Amnesty's main complaint is not about the British authorities' own actions but about efforts to deport people to places where they are likely—in Amnesty's view—to be tortured. In at least two ways, the report suggests, torture and inhumanity have been "globalised" to the point where few countries can be islands of virtue. States that would never practise torture found themselves colluding with the "extraordinary rendition" of terror suspects. And migration on a huge scale has tested the ability of countries to deal humanely with desperate people.

As it lists the misdeeds of one country after another, Amnesty's careful, plodding methodology acts as a brake on ideological fervour. But a sharper tone is struck in a foreword to the 2009 report by Irene Khan, the Bangladeshi-born secretary-general of the organisation. Primarily as a result of the economic crisis, "billions of people are suffering from insecurity, injustice and indignity," she says. In fact, "we are sitting on a powder keg of inequality, injustice and security, and it is about to explode."

Amnesty's individual country reports deal mostly with the sins and failures of governments, or else de facto administrations led by warlords. In other words, the reports reflect the classic human-rights concerns (freedom of the press, freedom from arbitrary arrest) which made the organisation famous after its establishment in 1961. But Ms Khan's list of adversaries also includes some very elusive ones: big business, climate change (see article) and impersonal economic forces—ranging from the global growth that galloped away until 2008 to the reversal of that process.

It would be hard to deny that globalisation and (to a much greater extent) its reversal have taken a human toll—but in any general account of the causes of human misery, mention could surely be made of autarchic dictatorships. In other words, countries like North Korea and Myanmar, which cut themselves off from the world economy at vast human cost.

Many observers of China agree that for all its dreadful human-rights problems, economic growth has helped to create a freer society: there is only so much control that a regime can exercise over a nation that is developing so rapidly and unpredictably. But Amnesty (perhaps inevitably, given its commitment to accentuate the negative) has little faith in economics or private business as a source of liberty.

Questioned about this, Ms Khan insists that Amnesty still sees governments as the agencies that matter most in delivering or repressing human rights. Where private firms gain too much authority (by using their own security companies, for example) it is still the fault of governments for failing to exercise countervailing power.

But unlike some critics of globalisation, Amnesty's boss doesn't see any category of governments as self-evidently virtuous or malign. In her view, the shift of global influence away from the rich north isn't all good: it has boosted the influence of some countries with a decent stance on human rights (Brazil, Mexico, India) but it is also empowering harsher countries like China.

At its worst, anti-globalisation rhetoric insists (borrowing the silly slogan of Alexander Kerensky, the Russian leader who lost out to the Bolsheviks) that there are "no enemies on the left"—a line which neatly absolves the sins of many a populist dictator, theocrat, kleptocrat or misogynist. By sifting facts from all countries, Amnesty seems to steer clear of that trap.

# Surviving the slump

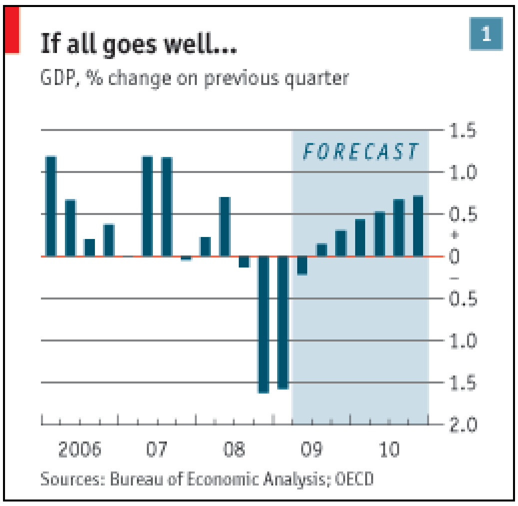
May 28th 2009
From The Economist print edition

**America's non-financial businesses are suffering. But they will emerge from the recession leaner and stronger than ever, says Robert Guest (interviewed here)**

Reuters


THE crisis began on Wall Street. Financial conjurors suddenly discovered that their tricks for making risk vanish had only disguised it. Their leveraged bets went sour, and the derivatives they thought insured them against any shock turned out to be worse than worthless. Trillions of dollars disappeared. Credit markets froze, and the pain spread to Main Street. This special report looks at how American business will cope with that pain and with the big policy issues that the country will face in the aftermath of the crash.

America's recession began quietly at the end of 2007 (see chart 1). Since then it has mutated into a global crisis. Reasonable people may disagree about whom to blame. Financiers who were not as clever as they thought they were? Regulators dozing Homer Simpson-like at the switch? Consumers who borrowed too much? Politicians who recklessly promoted home-ownership for those who could not afford it? All are guilty; and what a mess they have created.




Since 2007 America has shed 5m jobs. More than 15% of the workforce are jobless or underemployed—roughly 25m workers. The only industries swelling their payrolls are health care, utilities and the federal government. The value of listed shares in American firms collapsed by 57% from its peak in October 2007 to a trough in March this year, though it has since rebounded somewhat. Industrial production fell by 12.8% in the year to March, the worst slide since the second world war. Mark Zandi, an economist at Moody's Economy.com, predicts that the recession will shrink America's economy by 3.5% in total. "For most executives, this is the worst business environment they've ever seen," says Lenny Mendonca, chairman of the McKinsey Global Institute, a research group.

Times are so tough that even bosses are taking pay cuts. Median pay for chief executives of S&P 500 companies fell 6.8% in 2008, according to Equilar, a data provider. The overthrown titans of Wall Street took the biggest knock, with average pay cuts of 38% and median bonuses of zero. But there was some pain for everyone: median pay for chief executives of non-financial firms in the S&P 500 fell by 2.7%.

Nearly every business has a woeful tale to tell. For example, Arne Sorenson, the president of Marriott hotels, likens the crisis to the downturn that hit his business after September 11th 2001. When the twin towers fell, Americans stopped travelling. Marriott had its worst quarter ever, with revenues per room falling by 25%. This year, without a terrorist attack, the hotel industry is "putting the same numbers on the board", laments Mr Sorenson.

The hotel bust, like most busts, was preceded by a breathtaking boom. Although many other big firms resisted the temptation to over-borrow, developers gorged on cheap debt and built bigger and swankier hotels as if the whole world were planning a holiday in Las Vegas. When the bubble burst, demand collapsed. Hoteliers found themselves with a multitude of empty rooms even as a gaggle of unnecessary new hotels was poised to open.

Other industries have suffered even more. Hordes of builders, property firms and retailers have gone bust. And a "carpocalypse" has hit Detroit. Last year the American car industry had the capacity to make 17m vehicles. Sales in 2009 could be barely half of that. The Big Three American carmakers—General Motors, Ford and Chrysler—accumulated ruinous costs over the post-war years, such as gold-plated health plans and pensions for workers who retired as young as 48. All three are desperately restructuring. Only Ford may survive in its current form.

Hard times breed hard feelings. Few Americans understand what caused the recession. Some are seeking scapegoats. Politicians are happy to pander. Bosses have been summoned to Washington to be scolded on live television. The president berates their greed. The House of Representatives passed a retroactive 90% tax on bonuses at AIG, a bailed-out insurer. (The bill died in the Senate.) The attorney-general of New York threatened to release the bonus recipients' names unless they returned the cash.

## Extravagance is out

Retroactive taxes and personal threats? Businessfolk pray such habits do not spread. Meanwhile, they are bending over backwards to avoid seeming extravagant. Meetings at resorts are suddenly taboo. Goldman Sachs, an investment bank, cancelled a conference in Las Vegas at the last minute and rebooked it in San Francisco, which cost more but sounded less fun.

This special report will make several arguments. The pain will eventually end. American business will regain its shine. Many firms will die, but the survivors will emerge leaner and stronger than before. The financial sector's share of the economy will shrink, and stay shrunk for years to come. The importance of non-financial firms will accordingly rise, along with their ability to attract the best talent. America will remain the best place on earth to do business, so long as Barack Obama and the Democrats in Congress resist the temptation to meddle too much, and so long as organised labour does not overplay its hand.

The crisis will prove hugely disruptive, however. Bad management techniques will be exposed. Necessity will force the swift adoption of more efficient ones. At the same time, technological innovation will barely pause for breath, and two big political changes loom.

Mr Obama's plan to curb carbon dioxide emissions, though necessary, will be far from cost-free, whatever his sunny speeches on the subject might suggest. The shift to a low-carbon economy will help some firms, hurt others and require every organisation that uses much energy to rethink how it operates. It is harder to predict how Mr Obama's proposed reforms to the ailing health-care system will pan out. If he succeeds in curbing costs—a big if—it would be a colossal boon for America. Some businesses will benefit but the vast bulk of the savings will be captured by workers, not their employers.

In the next couple of years the businesses that thrive will be those that are miserly with costs, wary of debt, cautious with cashflow and obsessively attentive to what customers want. They will include plenty of names no one has yet heard of.

Times change, and corporations change with them. In 1955 *Time*'s man of the year was Harlow Curtice, the boss of GM. His firm was leading America towards "a new economic order", the magazine gushed. Thanks to men like Curtice, "the bonds of scarcity" had been broken and America was rolling "in two-toned splendour to an all-time crest of prosperity". Soon, Americans would need to spend "comparatively little time earning a living".

Half a century later GM is a byword for poor management. In March its chief executive was fired by *Time*'s current man of the year, Mr Obama. The government now props up the domestic car industry,

lending it money, backing its warranties and overseeing its turnaround plans. With luck, this will be short-lived. But there is a danger that Washington will end up micromanaging not only Detroit but also other parts of the economy. And clever though Mr Obama's advisers are, history suggests they will be bad at this.

# Trading down

May 28th 2009
From The Economist print edition

**From decadence to discounts**

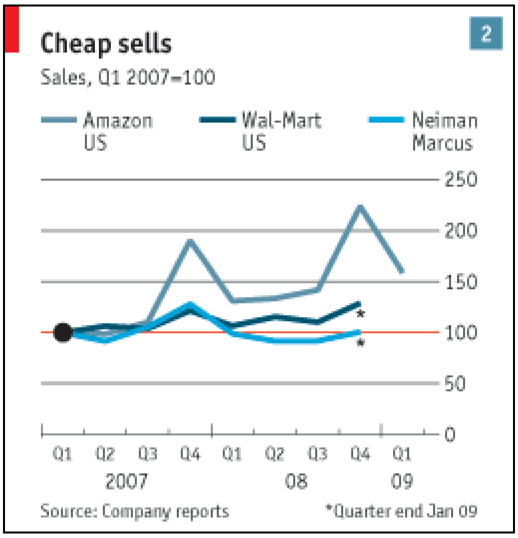
FIVE years ago Michael Silverstein and Neil Fiske wrote a book, “Trading Up: The New American Luxury”. They argued that Americans, even those of modest means, were abandoning merely adequate products for luxurious ones. Jake the construction worker, for example, splurged $3,000 on Callaway golf clubs, though he could have bought a set nearly as good for a third as much. (“They make me feel rich,” he said.) A shipping clerk on $25,000 a year bought silk pyjamas from Victoria’s Secret. A couple making $125,000 ordered a $4,000 brand-name cooking range, even though their kitchen came with a free generic one.

If you read the book backwards, it describes what is going on today.

Americans are trading down. If they still have jobs (as 91% of the workforce do), they are worried about losing them. Their homes are no longer cash machines and their investments are in a ditch. Household net worth fell by a staggering $11.2 trillion last year. The rich are cancelling orders for yachts. Working Americans are forgoing even small luxuries. Lindt & Sprüngli, a maker of exquisite chocolate truffles, is closing 50 of its 80 stores in America. Hershey’s, a maker of less chocolatey chocolate, is doing rather well. Limited Brands, which owns Victoria’s Secret, is not.

Americans are rediscovering thrift. Retail sales fell by 11% from their peak in late 2007 to April 2009. Personal consumption has fallen 2.5% since last summer. The Boston Consulting Group (BCG), a consultancy, finds that nearly three-quarters of Americans plan to curb their spending over the next year.

Trading down is not difficult. Instead of, say, blowing $4.50 on a Strawberries and Crème Venti Frappuccino from Starbucks, Americans are popping into Dunkin’ Donuts for a basic cuppa Joe at a buck or so. Instead of shopping at Neiman Marcus (a posh department store known colloquially as “Needless Mark-up”), they are driving to the out-of-town Wal-Mart superstore or shopping online for bargains at Amazon (see chart 2). A recent Pew poll found that 21% of Americans planned to grow their own vegetables, 16% had held a garage sale or sold things online and 10% had either taken in a friend or relative or moved in with one. Pundits are coining phrases such as “austerity chic” and “luxury shame”.




Four-fifths of Americans told the BCG they would defer big purchases that can wait. The most obvious example is a car. After a home, this is the most expensive object a typical family buys. New cars are nice, but old ones can last a long time, as any third-world taxi-driver knows. So Americans are keeping their old wheels on the road. Repair shops are bustling. Desperate dealers are offering interest-free finance. Hyundai, a maker of unflashy cars, has lifted its share of the American market by saying: buy a car from us, and if you lose your job we’ll buy it back.

The beneficiaries of the new parsimony are, unsurprisingly, firms that offer low prices. The only two stocks on the Dow Jones Industrial Average that rose in 2008 were Wal-Mart and McDonald’s. Wal-Mart, with its hyperefficient supply chain, is so good at squeezing costs that it has a measurable effect on the national inflation rate. McDonald’s is enticing cash-strapped diners with meals for as little as $1.

Americans who still eat out are doing so at cheaper restaurants. Russ Klein, a senior executive at Burger King, another fast-food chain, reckons that on balance the recession has helped his firm. High unemployment hurts breakfast sales, because jobless people have less cause to get out of bed. But overall, cash-strapped consumers are buying more burgers in paper bags and fewer steaks served on white linen.

The competition among the fast-food chains is exuberantly vicious. Burger King produces edgy advertisements in the hope that people will pass them around online. Earlier this year it offered users of Facebook, a social-networking website, a free Whopper burger if they would dump ten of their online friends. Facebook soon shut down the promotion, but not before Burger King was able to claim that the public's love of its flame-grilled product was "stronger than 233,906 friendships".

Another way Americans are saving money is by staying at home, so firms that offer a distraction from the horrors of family life are doing well. Netflix, which lets couch potatoes order films from a huge library for as little as $4.99 a month, said in April that it had shipped its 2 billionth DVD. Amazon, an online bookseller that has expanded into music, video games, hiking equipment and even sex toys, boosted profits by 24% in the first quarter.

Of course, if you are going to spend a lot of time at home, you need to be able to defend it. Gun sales are unusually brisk: FBI background checks in the three months from November 2008 were up by 31% on the previous year. Some Americans are stocking up in anticipation of tighter gun laws under Mr Obama. Others fear that the newly jobless will turn criminal. Neither fear is likely to prove founded, but gun stores are still running out of ammunition.

## The big squeeze

As consumers cut back, so do companies. Everyone is hoarding cash, trimming costs and painfully burning off fat. Inventories fell by 7% from August 2008 to March this year. Some industries will have to shrink dramatically to survive. Car-parts suppliers, for example, are in dire straits, despite a promise of $5 billion in emergency loans from the government. TI Automotive, which makes fuel tanks, has laid off a quarter of its white-collar staff in North America in the past year. Managers' salaries have been slashed. Blue-collar workers' hourly pay has been frozen and their hours cut by half. The firm is delaying paying its own suppliers unless they can deliver exactly what it wants, when it wants it.

Yet all this belt-tightening will not be enough. Car-parts suppliers must consolidate, says William Kozyra, TI's president. There are typically six to eight of them for each part. To achieve the necessary economies of scale, that must shrink to two or three, he reckons. Unfortunately, suppliers would need to borrow money to finance mergers or acquisitions, and no one will lend right now to an industry whose future is in such doubt.

Other industries are doing better. Few firms have the crushing legacy costs of GM or Chrysler, and few carry such unbearable debts. Most of America's non-financial firms did not go mad in the credit boom. In fact, since the dotcom and telecoms busts earlier this decade, many have put their balance-sheets in order. While households and financial firms went on a borrowing binge, non-financial firms stayed fairly sober. Household debt leapt from 71% of GDP at the beginning of 2001 to 97% in late 2008. Financial-sector debt vaulted from 85% to 121%. But non-financial firms' debt rose only from 66% to 78%.

Despite massive injections of taxpayers' cash to restore lenders' balance-sheets, it will be a while before the credit crunch ends. Between 2000 and 2007 the average American increased his personal consumption by 44%. This accounted for 77% of America's economic growth during that period. Much of it was financed by debt. In five years, American households extracted $2.3 trillion of equity from their homes. They blew 20% of this on consumption, 19% on sprucing up their homes and 44% on assets such as stocks.

The hangover from this party will be long and painful. Households' total outstanding borrowing fell in the fourth quarter of 2008, for the first time since the second world war. The personal-saving rate rose to 4.2% in the first quarter of 2009, from a nadir of minus 0.7% in 2005. "It is easy to see how consumer deleveraging could result in hundreds of billions of dollars-worth of forgone consumption in coming years," say Martin Baily, Susan Lund and Charles Atkins of the McKinsey Global Institute.

Getty Images

For most non-financial firms, however, there are a couple of bright spots in the gloom. Their balance-sheets are mostly healthier than the banks'. And for the strongest firms the downturn offers opportunities to snap up prime assets cheaply.

Consider Marriott. Although the hotel business tends to rise and fall in lockstep with the wider economy, not every hotelier is equally exposed. The Marriott name (or one of its sister brands) graces more than 3,000 hotels worldwide, but the company owns only half a dozen. The rest are franchised out or managed by Marriott for a fee. Since Marriott owns so few properties, it profits less during a boom. But it suffers less during a slump. It still collects franchise and management fees. Only its performance-related payments shrink.

So while owners are struggling, Marriott is scouting for bargains. Mr Sorenson, the company's president, predicts that distressed hotels could soon be on sale for half-price. He will buy some, perhaps, and sell them when times improve. Like the Rothschilds of old, Marriott likes to buy to the sound of cannons and sell to the sound of violins.

**Cleaning up in tough times**

## Making money by saving money

Firms that help other firms save money are also in a strong position. For example, Accruent, a Californian information-technology firm, helps big organisations make more efficient use of their land and buildings. Its clients include Target (a retailer), Lockheed Martin (an aerospace firm) and Yale University. Organisations such as these may have hundreds of properties, tens of thousands of pages of leases and a labyrinth of obligations to landlords, janitors and the taxman.

In good times property management is seen as a fixed cost, says Mark Friedman, Accruent's chief executive. But now firms are looking for ways to trim their bills. Accruent helps them build more rationally, find cheaper leases and fend off landlords who try to overcharge for extras. The recession creates new problems: leases don't expire just because you lay people off. Accruent helps firms shuffle employees around to create an empty building that can then be sold or sublet.

So its services are in demand. But the sheer unpredictability of the economy still makes Mr Friedman nervous. Quite often, he opens the *Wall Street Journal* and finds that something bad has happened to a firm he thought he was about to do business with. "It feels like we're driving at 100mph in a fog," he says.

On the plus side, many of the efficiencies discovered through necessity during the downturn will outlast it. For example, firms are cutting business travel by videoconferencing. Mr Sorenson of Marriott plays down the threat, arguing that there is no substitute for meeting people face-to-face. Others are not so sure. Videoconferencing technology keeps improving. Some meetings are necessary, but others are a waste of time. Mr Kozyra of TI Automotive predicts that, when the good times return, "we'll go halfway back" to travelling, and maybe send two executives to meet customers instead of six.

# Creative destruction

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From The Economist print edition

**The struggle is ugly, but the survivors will be stronger**

ON A quiet street in Romulus, a suburb of Detroit, is an empty house. Even if there were not a foreclosure sign outside, the rotting newspapers and broken toys on the lawn make it obvious that no one lives here. The owner lost his job and left last year, according to neighbours.

But the house itself is solid and spacious, with four bedrooms and an ample yard. Someone should buy it and fix it up, reckon the neighbours. So long as it is empty, it drags down the value of the surrounding properties, grumbles one, a retired car worker. “Homes round here used to sell for $120,000, but if you can get it for $25,000, that would be a good deal,” he suggests.

The house was sold that same day by an auction firm, Real Estate Disposition Corporation (REDC). The bidding started at a mere $500, but soon grew heated. “We’re approaching the bottom of the market! This is a great time to buy!” buzzed the auctioneer. As his sales patter rattled through the amplifiers, tuxedo-clad “spotters” dashed back and forth among the crowd spotting bidders and shouting out their bids.

The house in Romulus was one of dozens REDC auctioned on March 30th at a hotel in nearby Dearborn. It went for $32,000, to a local entrepreneur who plans to turn it into a home for the mentally ill. Perhaps not what the neighbours most wanted, but at least it will be occupied.

Such auctions are now common in America. They are a conspicuous sign of misery but they serve a purpose. If banks could not seize and sell homes with mortgages in default they would not lend in the first place. And though it may be heartbreaking for former owners to see their homes offloaded cheaply, low prices are good for first-time buyers.

The auction in Dearborn was packed with young couples who until recently could not afford to own a house. There were throngs of landlords, too, looking for bargains to buy, clean up and rent out. Someone has to do this. A mobile population needs rentable homes.

Some think the housing market is about to recover. Optimists took heart when sales of single-family homes rose in February but March’s weak figures undermined their hopes. Pessimists note that one home in nine is still empty. Between 2002 and 2007, at least 1m more homes were built than new households were formed. It will take a while for this surplus to be cleared. In much of the Midwest and north-east demand is unlikely to catch up with supply until 2012, by some estimates.

Bankruptcies are soaring. In the first quarter of this year, 20,251 companies filed for bankruptcy, a 52% jump from the same period last year, according to AACER, a firm that monitors such things. Including individuals as well as firms, AACER expects to see 1.5m bankruptcies this year, twice as many as in 2007.

Bankruptcy lawyers are busy. Douglas Bernstein of Plunkett Cooney, a Michigan law firm, says he could work 14 hours a day, 7 days a week and not keep up with the demand for his services. “Unfortunately, when the economy is bad, they don’t add hours to the day,” he grumbles in an e-mail from his office at 6am.

Companies that recycle the valuable parts of bankrupt companies are doing well, too. Distressed firms typically shed assets to raise cash so they can restructure and continue operating. If that does not work, they may go into liquidation. Everything must then be sold—the goods on the shelves, the shelves themselves, the leases on the shops, the websites, the trademarks, you name it. Firms such as Hilco, a privately held Illinois firm, can help, either by broking the sales or by buying assets themselves and selling them later. Richard Kaye, a vice-president of Hilco, says there has been a “significant uptick” in its bankruptcy business. In April, for example, the firm agreed to buy the remnants of Polaroid, a once-iconic instant-photo firm whose only significant asset now is its name.

Firms that prey on dead or dying firms are not popular. When someone calls you a “vulture”, it is not a compliment. But vultures have their place. The easier it is for lenders to collect what they are owed, the easier firms will find it to borrow. An efficient bankruptcy process is an essential part of capitalism red in tooth and claw. The weak die. The strong feast on their carcasses. Little is wasted.

In January Circuit City, an electronics retailer, went into liquidation, shutting more than 500 stores and selling its entire inventory. Shoppers snapped up bargains at its closing-down sales. Other retailers pounced on some of its properties. And its rivals in the iPod-and-toaster-hawking trade are fighting to woo its former customers. “We think there’s six to eight billion dollars of business up for grabs,” says Brad Anderson, the outgoing boss of Best Buy, Circuit City’s closest competitor.

An ideal bankruptcy system would transfer resources efficiently from less productive to more productive uses. How close does America come to this ideal? It is less ruthless than Britain, which is quick to force firms into liquidation, but less indulgent than France, which has a “huge bias” towards propping up zombie firms on the assumption that this will save jobs, says Michelle White, a bankruptcy expert at the University of California, San Diego. Overall, she thinks the American bankruptcy system does a “very valuable” job.

But Jack Williams of the American Bankruptcy Institute, a think-tank, adds a caveat. Firms are now finding it hard to use bankruptcy as a temporary shield to allow them to reorganise, because that usually requires a bridging loan of some kind, and at the moment no one is lending. That has given the system an unfortunate bias towards liquidation, he fears.

When times are hard, American firms find it easy to lay off workers. When times are good, however, they are quick to hire new hands. A ruthless labour market and a miserly welfare state have historically meant that Americans are more likely to have jobs (albeit often low-paid ones) than Europeans, and far less likely to be unemployed for a long time. In 2007 America’s jobless rate was 4.6%, compared with an average of 7.9% for the OECD’s European member countries. And whereas the average jobless American was out of work for less than four months, the average jobless European spent nearly 15 months involuntarily idle.

Eyevine

**Recessionary recipe**

During previous downturns, unemployment in America has risen more sharply than elsewhere but then fallen more quickly, too. This time round, it has certainly followed the painful first part of that script. Joblessness is already almost 9%, and the OECD predicts that it will hit 10.3% next year. The question is: will the labour market rebound as robustly as it has in the past? No one knows the answer. This recession has been particularly severe. More than 2% of American workers have been out of work for six months or more, which is close to a post-war record. And firms are cutting back on hours, too. The average working week fell by half an hour in 2008 to 33.2 hours, the shortest since records began in 1964.

## Now for the creative part

Despite the gloom, there are several reasons for believing that American business retains its underlying dynamism. First, one can listen to what businesspeople say. They may be feeling wretched this year, but few doubt that things will get better. Bill Green, the boss of Accenture, a consultancy, predicts that America will come out of the recession “much earlier” than other parts of the world. He talks constantly to other chief executives around the world, he says, and their consensus is that America will begin to recover later this year or in early 2010. They give three reasons. The recession started earlier in America than elsewhere. The government’s stimulus package is likely to work. And “they believe that we have a natural competitive streak—that people are going to want to get back in the game.”

Second, one can look at America’s admirable record of dealing with turmoil. A study by the Ewing Marion Kauffman Foundation, a think-tank that studies entrepreneurialism, found that America’s high rate of economic “churning” boosts productivity and hence material well-being. Between 1977 and 2005 some 15% of all American jobs were destroyed each year as firms closed or cut back. Thanks to the expansion of successful firms and the entry of new ones, however, many more jobs were created than destroyed.

Start-ups (ie, firms less than five years old) provided a third of the new jobs during this period.

Start-ups that went bust were on average 32% less productive than mature incumbents. Mature firms that went out of business were 27% less productive than mature survivors. Start-ups that survived, however, were 3% more productive than mature incumbents; five years later they were 5% more productive. This was true of all industries but especially retailing, in which stores the size of football fields have given way to even larger ones.

The credit crunch is making it harder for new firms to find capital. That matters: not all entrepreneurs start up in their garages with money from "family, friends and fools". In a survey for the Kauffman Foundation of 4,163 companies started in 2004, Alicia Robb and David Robinson concluded that 80-90% of start-up capital for a typical firm came from two sources. One was the entrepreneur's savings. The other was external debt: either a bank loan or a credit-card balance.

Most start-ups do not require huge amounts of capital. The average in the Kauffman sample was $78,000. Some need far less. Saudia Davis, for example, founded Greenhouse Eco-Cleaning, a green apartment-cleaning firm in New York, with $800 she earned from mopping floors herself. She now has between seven and ten cleaners working for her and would like to expand, but banks are not lending, she says. She is looking for an "angel" investor but this is tough when you have no intellectual property, so she may have to grow organically.

The recession itself sometimes generates start-up capital, in the form of severance payments. Adrienne and Kelly Lumpkin got their start with the help of a redundancy package Mr Lumpkin received from IBM in the early 1990s when Big Blue was in trouble. Alternate Access, their Raleigh, North Carolina-based firm, helps florists, doctors and other small enterprises do clever things with internet telephony. It offers call-centre services, for example, and sells software that helps employees see, on their computer screens, whether the person calling them is an important customer or a deadbeat.

Despite the recession, Americans started 530,000 businesses a month last year. And firms founded during tough times have to be tough. Although more firms typically start up in fat years, Paul Kedrosky of the Kauffman Foundation found that each bad year in America since the second world war produced just as many firms that have subsequently grown large enough to list their shares. He concludes that firms that begin in bad times are more likely to turn out to become economically important: think of Microsoft, Apple and Krispy Kreme doughnuts.

During good times, any idiot can get his ideas funded, says William Barnett, a professor at Stanford University's business school. During bad times, only the most impressive and persistent entrepreneurs can. Mr Barnett has discovered that firms which are set up shortly after a successful IPO (initial public offering of shares) by another firm that does roughly the same thing tend to do very badly. By contrast, firms founded shortly after news of the bankruptcies of firms doing roughly the same thing tend to do well. Google, for example, got started just after a clutch of other search-engine firms crashed.

During a crisis, says Mr Barnett, the market's signals are clearer. During a boom, people buy stuff without much thought. During bad times, they are much choosier. So only firms with genuinely superior products or services will thrive.

# Red tape and scissors

May 28th 2009
From The Economist print edition

**Despite crazy rules, convoluted taxes and rampant lawyers, America is still a great place to do business**

Getty Images

**Incomprehensible tax returns**

AMERICA is supposed to be the land of laissez-faire, but it doesn't seem that way to Erroll Tyler. He wants to run tours of Cambridge and Boston, cities that nestle on opposite banks of the Charles river. He would pick up punters in an amphibious vehicle, show them the sights and give them a pleasant cruise. But Boston will not let him. Officials say he needs a sightseeing licence. Alas, there is a moratorium on such licences. It was imposed for fear that Boston would get congested during the Big Dig, a construction project. But the Big Dig ended three years ago. Mr Tyler thinks the real reason he cannot get a licence is that someone is protecting a cartel of local tour operators. He is suing the city authorities.

Mr Tyler is not the only American who feels that red tape is garrotting his business. Senseless rules that benefit cartels are common. Oklahoma protects consumers from the perils of unlicensed interior decorators. Marylanders are barred from massaging animals without a vet's licence. Wisconsin until recently banned the sale of excessively cheap petrol (gasoline).

Not all rules are pointless. Under George Bush, the White House Office of Management and Budget reckoned the total yearly cost of federal regulations between 1997 and 2007 was $46 billion to $54 billion. The benefits, in terms of pollution averted, lives saved and so on, were far higher: $122 billion to $656 billion a year. But businessfolk still have plenty of gripes.

First there is the tax code. Overall, American taxes are light and the tax code is highly progressive. But corporate taxes are steep. Federal and state taxes on profits together average 39.3%, the second-highest rate in the rich world. And the system is repulsively complex. Federal, state and local rules accumulate each year in a vast and impenetrable heap. No one understands it. Some 82% of individual filers pay for professional help or tax software.

Big business can cope—clever accountants find all manner of lucrative loopholes. But small businesses "face a particularly bewildering array of laws, including a patchwork set of rules that governs the depreciation of equipment, numerous and overlapping filing requirements for employment taxes, and a vague set of factors that govern the classification of workers as either employees or independent contractors and that can keep businesses and the IRS battling each other for years with no obvious 'correct' answer." Those are not the words of an anti-tax zealot but of the Internal Revenue Service itself, in its annual plea to Congress to simplify the tax code.

A second gripe is America's lottery of a legal system. Litigation cost the country $252 billion in 2007, according to Towers Perrin, a consultancy. At nearly 2% of GDP, that is about twice the burden that lawsuits impose on other rich countries. Yet the Pacific Research Institute (PRI), a conservative think-tank, thinks it a gross underestimate. By including indirect costs, such as products never launched for fear of litigation, PRI arrives at a total of $865 billion a year. Of this, it reckons two-thirds is wasted; that is, it neither compensates the injured nor deters the reckless.

Whatever the size of the "tort tax"—and this is hotly disputed—nearly every business grumbles about the system's unpredictability. Most juries are reasonable, but many misunderstand complex disputes and some impose penalties that bear no relation to any harm suffered. Trial lawyers are adept at crafting suits aimed at whoever has deep pockets. Judges sometimes fail to apply common sense.

AP

**Free to be arm-twisted**

In a recent case, a patient lost an arm because a health assistant injected a drug into an artery. She sued the hospital. Fair enough. But she also sued the drugmaker, Wyeth, although the drug was approved by the Food and Drug Administration and came with six warnings not to inject it into arteries. She won $7m in damages. “The simple lesson businesspeople took was that the drugmaker could not have done anything to avoid being sued,” observed Gordon Crovitz, a columnist.

“Patent trolls” pose another problem. These are firms that buy up patents, not to turn them into products but solely to sue other firms that may have infringed them. Since the United States Patent Office grants patents freely and courts enforce them zealously, every inventive company lives in fear of trolls. If one can convince a court that a billion-dollar product incorporating hundreds of patents infringes only one of his, he can get an injunction to stop it being sold. The victim typically settles. Michael Heller, author of “The Gridlock Economy”, argues that such vaguely defined and aggressively asserted property rights stifle innovation and cost lives.

Another common complaint, especially among medium-sized firms, is that it costs so much to list on an American stock exchange. After the Enron scandal of 2001, in which auditors failed to notice a vast fraud at a publicly traded energy firm, disclosure requirements were tightened drastically. A hastily passed law known as Sarbanes-Oxley includes provisions for financial reporting that can cost millions of dollars to obey. Mark Friedman of Accruent says he cannot take his firm public because compliance costs might erase his profits. Founders of high-tech firms, who once hoped to make their fortunes with an IPO, now pray that a big firm such as Google will buy them.

Finally, businesspeople are worried about how the new administration might rewrite the rules. For the most part they are not reflexively hostile to Barack Obama. But since he has such a short record in office, they don’t know much about him; and they don’t like uncertainty. The government has taken control of large chunks of the financial and carmaking industries. Is this a temporary response to the crisis, as the White House insists? Or will the Democratic Congress, some of whose members would love to harness private firms to pursue policy goals, find ways to prolong it? No one knows.

A more immediate worry is a bill that would in effect abolish workers’ rights to a secret ballot before being unionised. The measure, misleadingly named the Employee Free Choice Act, would let a union win automatic recognition simply by cajoling a majority of employees to sign cards. The firm would then have to reach a deal with the union or accept one brokered by a government-appointed arbitrator.

If the bill passes—and it faces a struggle and possible revision in the Senate—unions hope it will revive their shrivelling membership. Businesses fear it will let unions do to them what they have already done to Detroit. Arne Sorenson of Marriott predicts that his typical employee, a diminutive Hispanic housekeeper with shaky English, will find it hard to say no to the tall, articulate union man who turns up and asks her to sign a card. Some Marriott hotels are already unionised—typically in cities that insist on it. Its non-union ones are 10% more profitable, says Mr Sorenson, mostly because of more flexible work rules. At one unionised hotel, he recalls, the pool attendant was not allowed to take the deck chairs out of the pool when the wind blew them in. It was not his job.

## Bigger is better

Despite such grumbles, nearly every entrepreneur and executive interviewed for this report judged the United States the best place in the world to make money—or at least, one of the best. Impartial observers tend to agree. “Doing Business in 2009”, a World Bank report on regulation, finds that America is the third easiest place to do business, beaten only by Singapore and New Zealand. Its labour market is the world’s most flexible. Starting a business involves few bureaucratic hassles: America ranks sixth out of 181 countries on this score. Enforcing contracts is straightforward (also sixth), as are registering property (12th) and trading across borders (15th).

Using a broader range of more subjective measures, the World Economic Forum puts America first out of 134 countries in its annual “competitiveness” rankings. It scores only adequately for macroeconomic stability (66th) and health and primary education (34th). But it ranks near the top for infrastructure and the efficiency of its market for goods. And it comes top for labour-market efficiency, absolute market size and innovation.

Amar Bhidé, a business professor at Columbia University, thinks these last two points are connected. Because America’s market is so huge, it is the best place to test new products. American consumers not only spend more than those of other nations; they are also more “venturesome”, says Mr Bhidé. That is, unusually willing to try new things. Their purchases reward innovators. And their feedback helps those innovators fine-tune their products.

Innovation tends to come incrementally, says Mr Bhidé. “Eureka!” moments are rare. More often, inventors incorporate at every stage what their customers teach them about what works, what doesn’t and why. Apple’s iPod, for example, was not based on truly original technology. Rather, it skilfully integrated technology from multiple sources and countries. Millions of Americans bought the clunky, expensive first version; it was much more popular in the United States than in other rich countries. Apple used the cash and feedback from the first iPod to develop smarter and more user-friendly versions. The product is now a global hit. A similar tale could be told of Amazon’s electronic book-reader, the Kindle.

Reuters

**Feedback made the iPod better**

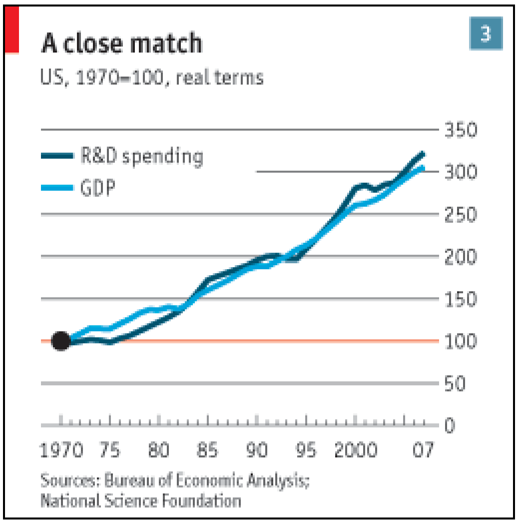
American customers know what they want, and they want it now. They are not always reasonable, but as far as businesses are concerned, they are always right. Saudia Davis of Greenhouse Eco-Cleaning recalls a client who demanded that she replace a cleaner who was ruining her apartment’s *feng shui* by being too thin. Ms Davis says she “yessed her to death” and sent someone else.

The only time customers do not know what they want is when they do not realise what is technically feasible. For that reason, Intel, a microchip-maker, hires ethnographers to watch people in their homes and search for unmet desires that might be fulfilled. They discovered that Americans still love television but would like to combine it with the internet in an undemanding way. With Yahoo!, an internet firm, Intel took a step towards this last year by unveiling the Widget Channel, which lets viewers look up such things as the name of the actress in the soap they are watching.

Despite the downturn, American firms continue to spend copiously on research and development (R&D). Software firms, which used to keep offering more and fancier features, are now concentrating on doing things more quickly and cheaply. In February Intel said it would plough $7 billion into factories in New Mexico, Arizona and Oregon to make chips with transistors so small that 60m could fit on the head of a pin. If something is technologically possible and you don’t do it, someone else will, says Paul Otellini, Intel’s boss.

Since 1970 industrial spending on R&D in America has never fallen significantly from one year to the next, though it dipped a bit after the dotcom crash of 2000-02 (see chart 3). This recession may be different, of course. Jules Duga of the Battelle Memorial Institute, a think-tank, predicts that R&D spending from all sources (government, business and universities) will rise by

3% in 2009 but contract slightly in 2010. As American firms outsource more technical work to cheaper countries such as India, however, they will find that each research dollar goes further.




Some observers worry that America is growing complacent about its technological prowess. In a report for the Information Technology & Innovation Foundation, Robert Atkinson and Scott Andes rank America 6th out of 40 countries for innovation and competitiveness, but contend that it has improved the least in the past decade. They liken America to “an ageing sports dynasty that has won the Super Bowl for many years but blithely ignores the rising performance of younger teams”.

But these rankings include measures that have little to do with innovation, such as the size of a country’s trade deficit. Also, they fail to give corporate America due credit for its knack of turning raw science into marketable products. Nearly all the best universities are American—17 of the top 20 by one recent ranking—and they all work arm in arm with industry. Firms that exploit advances in cloud computing or genomics tend to cluster around the top colleges. Start-ups are fed and nurtured by venture capitalists. Big firms snap up small ones with marketable ideas. That said, many of the best students and academics at America’s universities, and indeed many of the entrepreneurs they turn out, are foreign—which means that the country’s success in turning ideas into dollars would be imperilled if the recession prompted Congress to tighten immigration laws still further.

American firms such as Google, Microsoft and Cisco have changed the way almost everybody handles information. As yet unheard-of American biotech firms are working on drugs tailored to individual patients’ genomes. But one of the glories of American capitalism is the way firms apply complex technology to the most basic businesses. Hollywood uses awesome computer power to tell fairy stories. Burger King has invested oodles of money to develop restaurant layouts that let workers put sandwiches swiftly in customers’ hands. A study by Diana Farrell and other McKinsey researchers found that of the five sectors that contributed most to American productivity growth between 2000 and 2003, three were refreshingly unglamorous: retailing, wholesaling and administrative and support services.

# Life is expensive

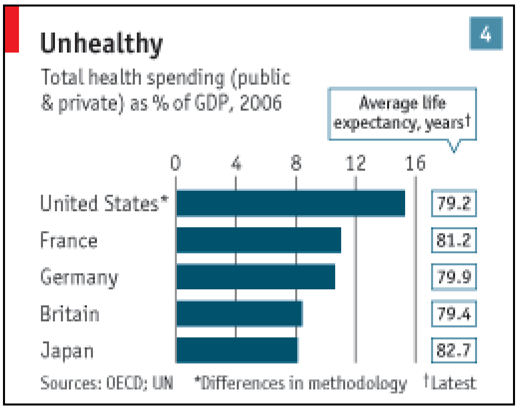
May 28th 2009
From The Economist print edition

**Treating the sickest part of America's economy**

A MIDDLE-AGED man felt chest pains. As an executive at IBM, an information-technology firm, he had excellent health insurance, so he went straight to a specialist. His cardiologist put him through a bunch of tests, including a computerised tomography scan. A radiologist noticed something odd in his neck, so he went to a neck surgeon, who checked him out and found nothing. He went back to the cardiologist, who gave him an angiogram, which caused dangerous complications and landed him in hospital for a while. In all, he ran up more than $150,000 in medical expenses before the chest pains disappeared on their own.

When they reappeared several months later, he spoke to Paul Grundy, the head of health-care technology at IBM. Dr Grundy, a doctor of preventive medicine by training, asked him if his lifestyle had changed recently. The executive mentioned that he had taken up gardening again. Dr Grundy quickly established that his chest pains sprang from a muscle he had strained through overzealous weed-whacking.

Such stories are all too common. Americans will spend a staggering $2.5 trillion on health care in 2009, says the Congressional Budget Office. As a share of national income that is far more than other rich countries spend (see chart 4), despite America's slightly younger population. To say that Americans do not get value for money is putting it mildly. They live no longer than Europeans and die younger than the Japanese. Meanwhile, 46m of them lack health insurance.




There are many reasons why American health care costs so much. Americans love fancy new medical technology. New drugs, for example, are prescribed a year or two earlier in America than in Europe, and do not come cheap. American doctors pay a fortune to insure themselves against frivolous lawsuits. A study in the *New England Journal of Medicine* found that even in cases where no medical error was found, plaintiffs received payments a quarter of the time. And half of medical malpractice payments were gobbled up by lawyers and overheads.

But the central problem is that most Americans get their health insurance through their employers. This dates back to the era of post-war wage controls, when firms offered benefits instead of pay rises. Today's tax code sets it in stone. Employers can buy health insurance with pre-tax dollars. Individuals cannot.

This creates an agency problem. When a typical patient goes to the doctor, he has no idea what anything costs. He pays only about 15% of the bill, so if the doctor recommends something he will probably say yes. The doctor gets paid for everything he does, so he has a powerful incentive to perform costly, unnecessary procedures. Besides, he may be socked for damages if he omits a test that a lawyer subsequently convinces a jury might have been useful. The costs are passed on to insurers, who pass them on to employers in the form of higher premiums, who then pass them on to workers in the form of lower pay.

This last point is not widely understood. Many Americans think of soaring health-care costs as a burden on companies. And it is true that some high-profile ones, such as carmakers, have come unstuck by promising health benefits that subsequently became too expensive. GM spends more on health insurance than on steel. It is also true that small firms find the bureaucracy of health insurance hasslesome. However, in general the real victims of health-care inflation are not businesses but ordinary Americans. As the cost of coverage rises, their wages are squeezed, or coverage is dropped altogether.

The proportion of the cost of employer-provided health insurance shouldered by employees is "at or close to 100%," says Jonathan Gruber, an economist at the Massachusetts Institute of Technology. Last year, employer-provided health insurance reduced wages by 7.9%, according to the Bureau of Labour

Statistics. The stagnation of middle-class incomes in recent years is in large measure caused by health-care inflation. Tying people's health insurance to their jobs also makes it harder for them to switch jobs or set up their own firms.

Reforming health care is Barack Obama's domestic priority. He is determined to increase coverage and curb costs. To increase coverage, he would subsidise individuals and small firms to buy insurance and bar insurers from excluding sick people. To promote competition, he would create a national insurance exchange where people could shop for different plans. As well as private insurance, he would offer people the option of buying into a public plan like the one that covers federal workers. To curb costs, he would promote the use of information technology and "evidence-based medicine", the notion that you measure what works and only do it if it does. He would also allow imports of drugs from countries where they are cheaper (for example, because prices are set by a state monopsony).

Getting all this through Congress will be an ordeal, as Hillary Clinton discovered in the 1990s. But some kind of reform is likely, perhaps this year. The consequences could be far-reaching. Mr Obama seems determined to offer every American the option of buying government health insurance and if Congress agrees, private insurers will be walloped—some say wiped out.

A government scheme could offer much lower prices. Unlike a private insurer, it would not have to make provision for future liabilities; it could simply stick the bill to future taxpayers. Medicare, the government scheme for old people, has unfunded liabilities of $36 trillion—two-and-a-half times America's GDP. If opened to all, it could undercut private insurers by "screwing our children and grandchildren", says Regina Herzlinger, a health-care expert at Harvard Business School.

The insurers that survive will be those that keep costs under control. Fee-for-service insurance must adapt or wither. Managed care will return. This is the model whereby doctors work for the insurer, which pays them to keep people well. Instead of letting patients go straight to a specialist, managed-care firms like Kaiser Permanente make them see a primary-care doctor first, who will figure out whether the problem is serious. This is crucial. Specialists tend to recommend their own specialism—surgeons advocate surgery, and so on. The lack of a gatekeeper in traditional fee-for-service insurance leads to over-doctoring that is often harmful as well as costly, as that IBM executive discovered.

Managed care, provided by firms also called health-maintenance organisations, (HMOs), grew rapidly in the 1990s but then retreated. One reason, according to Alain Enthoven, a health-care specialist at Stanford University, is that firms pushed their staff into HMOs without a choice, which angered many. Another is that they failed explicitly to pass on the savings to employees. This might change. For example, Stanford gives employees a choice of five health plans. If they pick the cheapest, (Kaiser, which is also arguably the best, says Mr Enthoven), the university pays the full cost. If they pick a more expensive one, they must pay the difference. Four-fifths choose an HMO.

## The high price of pills

Health-care reform worries drug firms. Under the current system, Americans not only adopt new drugs more quickly than people in other rich countries; they pay 50% more for the same drugs, according to McKinsey. In a more government-dominated system, drug firms' profits would suffer. So would their incentive to innovate. It typically costs them a billion dollars to develop a new drug. They can only recoup their vast R&D outlays thanks to high margins in America. The rest of the world enjoys a free ride. But that could change.

Getty Images

Billy Tauzin, the drug industry's chief lobbyist, protests that European-style rationing would cost American lives. But drug firms are already bracing themselves for leaner times. Several are merging to cut overheads and pool their research skills: Merck with Schering-Plough, Pfizer with Wyeth, Roche with Genentech. And many are finding that they can cut costs by outsourcing drug-testing. Quintiles, the largest firm that undertakes such work, saw its revenues grow by 19% last year. Pharmaceutical research is getting more expensive because it is getting more complex, says Dennis Gillings, Quintiles's chief executive. Many new drugs are aimed at old people who may already be taking several other pills. Testers have to be sure that they will not interact harmfully.

Mr Obama plans to spend $19 billion to promote health IT. The system is sorely in need of the efficiencies that digitisation might make possible. Only 4% of American doctors have a fully functional electronic medical-records system and another 13% have only a basic one, according to the *New England Journal of Medicine*.


**I'm afraid we'll have to remove your wallet**

Simply putting computers on doctors' desks is not enough, however. They must have incentives to use them. For managed-care firms, the incentives are already there. If their doctors can call up a patient's medical records on a screen, along with information about suitable treatments, they can get better results for less money. Fee-for-service doctors, who gain nothing by providing more cost-effective care, have been slower to digitise. Mr Obama says he will offer them incentives to do so. Meanwhile, private firms are trying to show them that IT can make their lives easier.

By chance, one of these firms, Athena Health of Massachusetts, is run by a cousin of George Bush. Rather than trying to sell doctors software which they might never use, Jonathan Bush says he uses software to provide a service, just as Amazon uses software to deliver books. His firm helps 13,000 doctors to digitise their patients' records and handle the maddening process of billing insurers. Mr Bush says his clients get paid 11% more than before (because insurance firms' bureaucracy sometimes used to defeat them) and 34% faster. He saves the patients money, too. Doctors without electronic records often find it easier to do another $500 chest X-ray today than to dig up the results of the one they did yesterday, marvels Mr Bush.

# A green revolution

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From The Economist print edition

**Saving the world will not be cheap**

THE best way to curb global warming would be a carbon tax. The money raised could be divided up among citizens or used to repay the national debt. A tax on carbon dioxide ($CO_2$) would give everyone an incentive to emit less of it. It would be simple, direct and transparent. For these reasons, it will never happen in America.

Frank talk about energy policy is rare. Politicians hate to admit that anything they plan to do will cause pain to any voter. During the election campaign, both Barack Obama and John McCain proposed a cap-and-trade system for curbing $CO_2$ emissions, not because it would work better than a carbon tax but because it did not have the word “tax” in its name. Both candidates also gave the impression that their green policies would yield huge benefits while imposing no costs. A shift to alternative energy, they agreed, would not only check global warming but also create millions of green jobs and help break America’s dependence on foreign oil.

Neither dwelt on the fact that cap-and-trade will raise energy prices, that subsidies for renewable energy will have to be paid for, or that both policies will destroy jobs as well as creating them, while probably cutting growth. The Congressional Budget Office estimates that a 15% cut in $CO_2$ emissions will cost the average American household $1,600 a year. If politicians pretend they can save the planet at no cost, they risk a backlash when people realise they were fibbing.

Greenery is both fashionable and in flux. Every business wants to boast about its efforts to avert climate change, even if those efforts, on closer inspection, amount to little. At the same time, many big investments in planet-cooling activities are on hold because no one knows what incentives the government will put in place, and when. This year’s economic-stimulus package allocated $65 billion in subsidies and tax breaks to the energy industry, most of which had at least a green veneer. But the big reforms are still to come. First and most important is cap-and-trade. The budget Mr Obama submitted to Congress in February assumes that such a system will be up and running by 2012. Tradable permits to emit an amount of $CO_2$ will eventually be auctioned to the highest bidders.

Mr Obama’s budget assumed he would raise $80 billion a year from cap-and-trade, of which $15 billion would go to subsidise renewable energy, and the rest would pay for a tax credit for all but the richest 5% of Americans. For many, that would make up for higher energy bills. For those who live in states that mine or burn a lot of coal, however, it probably would not.

SpecialistStock

**Room for plenty more**

This is where the problems start. Mr Obama's plan must pass through Congress, which is doing its best to make it murkier, more complex and less effective. Every state, industry and special interest is clamouring for loopholes or handouts. On May 15th Henry Waxman, a Democrat who heads the House energy committee, disgorged a 932-page cap-and-trade bill that would loosen Mr Obama's emissions targets and give away 85% of the permits to pollute, while auctioning the rest.

House Democrats say this is the best possible compromise. Greens say the bill does far too little to cut emissions. Fiscal hawks fret that it would mess up Mr Obama's budget. Its micromeddling guarantees unforeseen consequences, just as biofuel subsidies seem to have encouraged the use of nitrous oxide-spewing fertiliser. No one knows how the bill will fare in the Senate. Meanwhile, many businesses say they prefer it to a mooted alternative—regulation of greenhouse gases by the Environmental Protection Agency.

Mr Obama's other big plan is to insist that 10% of electricity be generated from renewable sources by 2012 and 25% by 2025. That implies a surge in wind, solar, hydroelectric and geothermal power, and so on. If that target were rigidly enforced (for example, if firms get no credit for energy efficiency), the Boston Consulting Group reckons that 50-60 gigawatts of renewable capacity would be needed, over and above current projections, by 2012.

Clean-energy firms are salivating. Most have been hit badly by the plunge in the price of oil. And the financial crisis has curtailed, at least temporarily, new lending for investment in green technology. But many predict that, once the recession is over, oil prices will rise again, making alternative fuels seem less expensive. Combined with the incentives being proposed, this could lead to a green-energy boom.

Wind power accounts for only 1% of electricity generation in America. It could "easily" rise to 30%, says Ditlev Engel, the boss of Vestas, a Danish firm which is the world's largest maker of wind turbines. America has ample wind, blowing across the plains from North Dakota to Texas. Not harvesting it would be like Saudi Arabia not drilling for oil, he says. Vestas is investing $1 billion in factories in Colorado.

Solar energy is more expensive than wind. It depends on fat subsidies, which means the biggest market is Europe and cloudy Germany is covered with solar panels whereas sunny New Mexico is not. But several firms hope to make solar technology cheaper. For example, First Solar, an Arizona-based firm, makes thin-film solar panels that are more cost-effective than most existing ones. It plans to double its production this year, to 1,000 megawatts, says its boss, Mike Ahearn.

## The nuclear option, again

In his election campaign Mr Obama dodged the subject of nuclear power. "New Energy for America", his eight-page energy manifesto, mentioned it briefly, without enthusiasm. But it is hard to imagine halting climate change without it. Windmills and solar panels provide power only intermittently. To avoid blackouts an energy source that keeps flowing in any weather is needed. Nuclear power, whose CO2 emissions are tiny, fits the bill. But no new nuclear plant has been built in America for 35 years. Mr Obama is now mulling loans to restart the industry. Given the huge upfront costs and the certainty of resistance from environmentalists, firms will have to know the government is serious about curbing CO2 before they commit themselves to building nuclear plants.

Oil and natural-gas firms are in no immediate danger. ExxonMobil earned $45 billion in profits last year, making it the most profitable firm in America. With oil prices barely a third of their peak, that will not happen again this year. But oil is too useful to become obsolete any time soon, and gas is relatively clean. Coal faces a greater threat, and not only because Al Gore is calling for protests against coal-fired power plants. Since coal is the dirtiest of the main fuels used to generate electricity, cap-and-trade could lead such plants to shut or switch to gas. Efforts to make coal cleaner by injecting its CO2 emissions into the ground show little sign of becoming cost-effective, despite subsidies. Only the fact that coal is plentiful in swing states gives the industry hope.

If a price is imposed on CO2 the next big obstacle to renewable energy will be the electricity grid, which is antiquated and sclerotic. Regulations vary from state to state, making it hard to transmit energy across state borders. There are not enough lines to send power from, for example, windy states to populous ones. New construction is stymied by an attitude among regulators and environmentalists colloquially known as BANANA (Build Absolutely Nothing Anywhere Near Anyone).

And the commonsense notion that consumers should be able to sell energy back to the grid as well as

buy it has barely taken root, except in California. Lynn Orr, a professor at Stanford University, has solar panels on his home. During the day he sells power to the local utility at 29 cents a kilowatt-hour. At night he buys it back for 9 cents. The system is not perfectly flexible. He can reduce his bill to zero but no further. “So I need an electric car,” he muses.

Mr Obama included incentives for building a smart grid in his stimulus package. Businesses are queuing to build one. “This is the most sexy industry to work in,” says Guido Bartels, who leads the energy team at IBM. A smart grid would involve sensors to monitor power flow in both directions, and software to help crunch all the data thus generated. If you plug in your electric car at a friend’s house, you will want an easy way to be billed, says Mr Bartels. And information can be used in myriad ways to make the system more efficient, for example by imposing variable prices to discourage power use during periods of peak demand. Energy is one of the fastest-growing parts of IBM’s business. Manufacturers such as GE and ABB build the physical infrastructure, while IBM vies with such firms as Accenture to supply the information technology and integrate it all.

If the government introduces carbon-curbing incentives, there will be rich pickings for firms that uncork the remaining technological bottlenecks. For example, whoever makes a cheap, powerful and efficient battery for an electric car will be well rewarded. Firms like A123Systems of Massachusetts are working on it, but electric cars are still too costly for most people.

## Saving the planet with old tyres

Since nearly every activity requires energy, there are limitless angles from which to address the problem. Lehigh Technologies of Tucker, Georgia, uses cryogenic technology to create a recyclable powder from old tyres. Because the process saves oil, customers will one day claim it as a $CO_2$ offset. Modestly, Lehigh calls its product “The Powder to Save The World”.

Many Americans fret that if cap-and-trade raises domestic energy prices, industries will migrate to China. Stefan Heck of McKinsey thinks that unlikely. Firms outsource labour-intensive jobs to China because there is a huge difference in labour costs even after accounting for productivity differences. Cap-and-trade might add 20-30% to energy costs. That is a lot, but not enough to spark a mass exodus.

Although the shift to a low-carbon economy will reduce economic growth overall, there are plenty of ideas that pay for themselves. Making buildings more energy-efficient is an example. Companies such as Ameresco offer to do this in return for a share of the savings. Firms such as Serious Materials of California provide energy-saving windows and environmentally friendly plasterboard. Wal-Mart plans to reduce its packaging, thereby cutting hundreds of thousands of truck trips and saving both emissions and cash.

In Europe, whose cap-and-trade system is already in force, $CO_2$ prices are routinely factored in to business decisions. In America, they are not—yet. Forest Reinhardt, an environmental specialist at Harvard Business School, argues that consumers of fossil fuels should pay for all the externalities: not only emissions, but also the cost of policing the Middle East.

But he concedes that the shift will be extremely hard. The location of everything in America assumes that petrol will cost about $1 a gallon, he says. Commutes are too long. Cars and lorries are too big. Cities are much greener than rural areas: apartments and public transport are more energy-efficient than big houses and pickup trucks. But not everyone can move to a city centre. People in Montana need a car to get around. They are not rich, they spend a big chunk of their disposable income on petrol, and they do not want to move to Massachusetts. The government has to get the incentives right, says Mr Reinhardt, but it is hard for it to make commitments that will bind its successors in, say, 2017.

# The fragile web of foreign trade

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From The Economist print edition

**The recession makes globalisation more necessary, but more precarious**

A FEW years ago, Niall Ferguson and Moritz Schularick, two economic historians, coined the term "Chimerica" to describe the symbiosis between the world's two great powers. Chinese people save, they observed, allowing Americans to borrow and spend more than they earn. American consumers buy gizmos made in China, keeping Chinese workers in jobs. Both countries benefit.

But the financial crisis has caused many people to rethink this comfortable arrangement. Protectionists have long blamed Chinese imports for destroying American jobs. A new gripe is that, by lending America so much money, China helped inflate the asset bubble that has now burst so painfully. Although no one forced Americans to borrow so much, nor to gamble the money on property, the crisis has fuelled nativist anger. Lawmakers added "Buy American" clauses to this year's stimulus package, and there are still absurdly tight limits on the number of skilled foreigners who can work in America.

The American and Chinese economies are so entwined, however, that any attempt to separate them will end in calamity. If China were suddenly to stop buying US Treasury bills, it would plunge America into a fiscal crisis. It could also spark a collapse in the dollar and thereby wipe out a big chunk of China's foreign-currency reserves, so both sides have an interest in preventing it from happening. This mutual dependence applies to businesses, too. Chinese manufacturers need America's huge market. American firms, to stay competitive, need to buy things from China.

It is increasingly hard to tell if some companies are American or Chinese, says Jonathan Woetzel, a China specialist at McKinsey. Consider Cheung Yan, who was until recently China's richest person. With her husband, she set up a firm in California to gather American waste paper and ship it to China to be recycled. Later, she set up paper factories in China to do the recycling. Some of the waste paper is turned into boxes to hold Chinese-made electronic goods that are then shipped to America. Is their business Chinese or American? And does it matter?

The recession has severely disrupted trade between America and more or less everywhere else (see chart 5). China's exports to the United States, which had more than trebled between 2002 and 2008, collapsed by more than half between September 2008 and February 2009. The slump in American consumer spending may be causing as much pain for some Chinese exporters as it is for American businesses. But hard times are forcing American firms to look harder for savings, and many are finding these in China.


Ever more industries are finding that their supply chains can run through China, says Jimmy Hexter, another McKinseyite and co-author, with Mr Woetzel, of "Operation China". Wal-Mart's chief procurement officer lives in Shenzhen. For cheap retailers, not buying goods from China would be suicidal. But as Chinese firms grow more sophisticated, they are selling fancier stuff. China's exports to America of machinery and electrical goods, for example, grew at twice the pace of its textiles exports between 1993 and 2008.

For American firms setting up in China, the chief attraction these days is not its cheap labour but its increasingly affluent consumers. In a recent survey of American firms in China by the American Chamber of Commerce there, 63% said they were there to sell to locals, whereas only 9% said they were there to sell things back to America. Procter & Gamble is so well established that many Chinese think its products (such as green-tea-flavoured Crest toothpaste) are local brands. GM is doing well in China, unlike at home. American firms are jostling to help China build smart infrastructure and tackle pollution.

American business is as deeply entangled with other parts of the world, too. Supply chains criss-cross

oceans, letting firms buy whatever they want from whoever makes it most efficiently. Despite Barack Obama's claim that green jobs cannot be outsourced, a study by Brown-Wilson Group, a research firm, finds that they can. Granted, the man who fixes a solar panel to a roof in Ohio has to be in Ohio. But the panel itself can be made in China, and the software for the smart grid that will one day make the solar panel economic can be written in India. Without free trade, saving the planet will cost a lot more.

# The coming recovery

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From The Economist print edition

**It could take a while, but Main Street will bounce back**

Getty Images


JOHN RICH, a country-music star, sings an angry song about the recession. “While they’re living it up on Wall Street in that New York City town/Here in the real world they’re shuttin’ Detroit down,” complains Mr Rich. He adds that “The boss man takes his bonus pay and jets on out of town/And DC’s bailing out them bankers as the farmers auction ground.” The accompanying video shows a car worker losing his job and home.

Mr Rich is not just another bleeding-heart celebrity. He wrote John McCain’s campaign song last year and performed at the Republican convention. But he is furious about fat-cats. And whereas one can quibble that the folks on Wall Street are not really having much fun this year, or that carmakers and farmers have also received hefty subsidies, it is worth pondering his rage, for it is shared by Americans of every ideological hue.

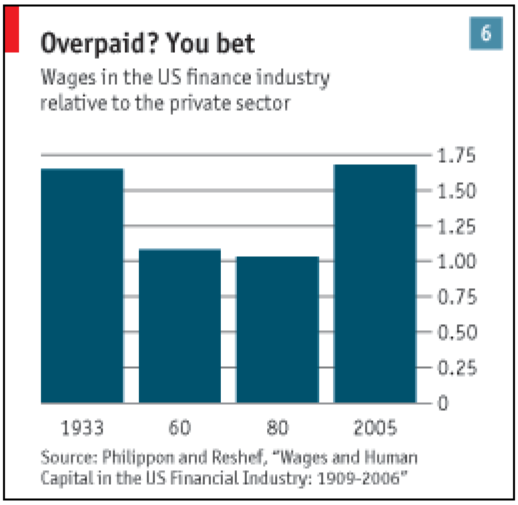
Few understand what a credit-default swap is, but everyone knows that Wall Street messed up, and nearly everyone feels it, too. Those who have not lost a job have seen their wages frozen or the value of their savings crumble. The financial collapse has exposed newsworthy frauds, like the colossal Ponzi scheme run by Bernard Madoff. Such swindles were not typical. The crisis owes far more to incompetence than criminality. But neither explanation reflects well on the captains of capitalism.

A Rasmussen poll in April found that only 53% of Americans think capitalism is better than socialism, with 20% preferring socialism and 27% unsure. Those are alarming numbers for believers in free markets. They may be misleading, however. Some Americans are hazy about what “capitalism” and “socialism” mean. A later poll found that 77% of Americans preferred a free-market economy to one managed by the government. And hardly anyone thinks the government would do a better job than the private sector of running banks or car factories.

Americans are angry first and foremost with financiers. They also take a dim view of overpaid and underachieving bosses, particularly if they fly to Washington by private jet to beg for a handout from taxpayers. But they admire entrepreneurs: 79% think them critically important to job creation. And although a slim majority approve of Barack Obama’s expansion of government to tackle the immediate crisis, only 13% want that expansion to be made permanent. In short, Americans favour incremental rather than radical change. They want to see Wall Street tamed, but they are not clamouring to reinvent the relationship between government and business.

They will probably get their wish. The financial industry grew far too big. Its share of corporate profits in America peaked at an incredible 41% in 2007. Its employees, who were paid about the same as those in other industries until the early 1980s, pocketed 1.8 times as much in 2007 (see chart 6). Judged by the fruits of

their labours, they did not deserve it. Thomas Philippon of New York University and Ariell Reshef of the University of Virginia estimate that 30-50% of the wage gap between financial and non-financial workers between the mid-1990s and 2006 was the fruit of what they judged to be rent-seeking rather than genuine wealth-creation. That will now change. A smaller, humbler, more regulated financial sector will emerge. Many of the brainy youngsters who used to flock to investment banks or hedge funds will put their talents to other, perhaps more productive, uses.




Mr Bush of Athena Health thinks this is terrific. The clever people he could not recruit because Goldman Sachs was paying them $65,000 a month are suddenly available, he says. Robert Kaplan of Harvard Business School, a former vice-chairman of Goldman Sachs, applauds the prospect of pay in financial services reverting to less giddy levels. Only people genuinely interested in finance will seek careers in it, he says. Fewer will do jobs they hate just for the money. More will start their own companies. Mr Bhidé of Columbia University calls for a return to "more primitive finance", with deposit-taking banks strictly regulated and strictly separated from the more innovative, risky financial firms, to avoid a repeat of the recent contagion.

Main Street will recover only when America's finances are on a sounder footing. That will take time. Total private-sector debt (households, financial and non-financial firms combined) reached nearly three times GDP last year. Reducing that load will hurt. Money spent repaying debt cannot be spent on the products that American firms are so desperate to sell.

Corporate profits collapsed by 10% last year, and continue to slide. But they will eventually rebound. Chris Varvares, the president of Macroeconomic Advisers, a consultancy, predicts that they will find a sustainable level of about 9% of GDP by 2011. That is well short of their 13% share in 2006. But it is high enough, for example, to help pension funds to start recovering from their recent pummelling.

There are reasons for guarded optimism. One is Mr Obama. Businessfolk worry that he is too cosy with lawyers and labour unions, that he will raise taxes to enterprise-throttling heights, or that his propping-up of badly run firms is unfair to their better-run competitors. None of these worries is baseless. But the evidence so far suggests that the new president understands America's economic problems and is pragmatic about seeking solutions. There is no reason—yet—to doubt his promise to tackle the budget deficit once the crisis subsides. And America is fortunate to have had a change at the top just as the crisis exploded. A crisis requires a bold response. Mr Obama's fresh mandate and personal popularity make it easier for him to provide one.

## The spirit of enterprise

When the crisis ends, America will still be the best place in the world to do business, says Niall Ferguson of Harvard University. Unlike in parts of the developing world, its political stability is not in doubt. American innovation continues apace, just as it did during the Depression of the 1930s (which saw the invention of nylon, canned beer, the photocopier and the drive-in cinema) and the stagflation of the 1970s (Post-it notes, bar codes, the microprocessor). Not only is America's market the largest, but that market is homogeneous: a firm that works in one state can probably work in any other. "I laugh when people talk about diversity here," says Mr Ferguson. And America has economic policy levers commensurate with its size: the European Union has no central treasury to compare with America's, and America's central bank has acted more aggressively to tackle the crisis because it can.

Finally, there is that gung-ho spirit of enterprise. "I think people will be surprised how quickly [business] will pick up when it does," says Mr Sorenson of Marriott hotels. One can discount his words, of course. Business people are by nature optimistic, especially in America. But their optimism can be self-fulfilling.

# Sources and acknowledgments

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Indian firms' foreign purchases

# Gone shopping

May 28th 2009 | DELHI
From The Economist print edition

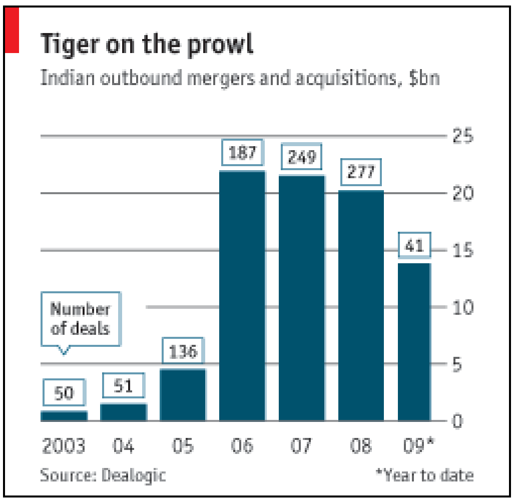
**As Indian companies juggle their pricey foreign acquisitions, the country's largest telephone company embarks on the biggest shopping expedition of them all**

Illustration by David Simonds


INDIANS are fond of shopping abroad, a habit left over from the era of import substitution, when they had to put up with shoddy homespun goods in the name of national self-sufficiency. This taste for overseas purchases is shared by Indian companies. Between 2000 and 2008 they announced over 1,000 international mergers or acquisitions, worth over $72 billion, according to Dealogic, a research firm. Most of those deals have been sealed since 2006 (see chart).

On May 25th Bharti Airtel, the country's biggest mobile-network operator, announced that it was exploring a deal that would surpass the $12 billion Tata Steel paid for Corus, an Anglo-Dutch steelmaker, in 2007: a tie-up with MTN, a South African mobile giant, which rebuffed a previous approach last year. The deal, if it ever happens, would create one of the world's biggest mobile operators, with 200m fixed and mobile subscribers across 21 countries.

Corporate India's shopping spree gained momentum after 2002, when the rapid growth of the Indian economy began to bolster companies' balance-sheets. India's regulators also relaxed their grip, steadily raising the limits on investments abroad. Outward investment, they once believed, deprived India of scarce capital that would be better invested at home. But this fear of capital flight slowly gave way to pride in India's national champions. In February 2004, they even allowed firms to finance their foreign acquisitions by borrowing abroad.




And borrow they did. Indian companies took on a mountain of debt, largely because it was there. Tata Steel borrowed heavily to buy Corus in 2007. Hindalco, India's biggest aluminium company, borrowed $3 billion to buy Novelis, a Canadian manufacturer of aluminium products. Suzlon, which makes wind turbines, sold convertible bonds to finance its acquisition of Germany's REpower.

But whereas Indian tourists have an eye for a bargain, several of corporate India's acquisitions now seem ill-advised. The purchase of Jaguar Land Rover (JLR) in 2008, for example, saddled Tata Motors with a prestigious brand, prodigious losses and a $3 billion loan, the last $1 billion of which it managed to refinance on May 27th, days before it fell due. It has had to call on the help of the Tata Group's holding company, which underwrote its faltering rights issue last year, and the indulgence of India's biggest state bank, which guaranteed an $840m bond it floated in May. In a recent interview, Ratan Tata, the group's chairman, admitted that the company bought JLR at an "inopportune time".

So were these acquisitions fundamentally sound decisions cursed by poor timing? Or were they bad decisions flattered by easy money? Some suspect that the country's corporate titans felt compelled to outdo one another. But Alan Rosling, who sat on the board of the Tata Group's holding company during its rapid overseas expansion, makes the opposite case: the Tatas' foreign acquisitions were not daring, they were in part defensive.

In the 1990s Mr Tata inherited a group that sprawled across many industries, but remained largely cooped up in a single country. As India opened its economic borders, the group would have to contend with foreign competitors at home, whether or not it ventured overseas. There was nothing prudent about remaining subscale in a newly open market, prey to foreign multinationals.

Gautam Thapar, chief executive of the Avantha group, which includes Crompton Greaves, an engineering firm, cites a similar motivation for some of the company's overseas acquisitions. It retains over a quarter of the Indian market for power transformers, which it defends against global rivals such as ABB. To hold on to that share in the long run, Mr Thapar argues, it has to compete on the basis of the technology it offers as well as the price it charges.

The pursuit of technology is a powerful motive for foreign acquisitions. Before Tata Steel's purchase of Corus, the Indian steelmaker did not hold a single American patent. The takeover bought it over 80, as well as almost 1,000 research staff.

Sometimes new markets and new technologies go hand in hand. In India, Mr Thapar points out, the traditional buyers of transformers are state electricity boards, interested mostly in cost. The spur for innovation comes from more sophisticated foreign customers, who are "willing to sit down and discuss ideas". One of his acquisitions, for example, makes slim transformers which tuck inside the shaft of wind turbines, saving space in crowded European countries.

Western acquisitions often have a crude motivation: to combine revenues without combining costs. Savings must be identified in advance to justify the deal to shareholders, and realised quickly afterwards. The result is a disruptive yoking together of two organisations, shaking up management and laying off staff, which as often as not fails to achieve its aims.

Because Indian companies are often seeking know-how and technology, they treat their new acquisitions with greater respect and forbearance, argues Nirmalya Kumar in the *Harvard Business Review*. They are careful not to break what they have just bought, as Mr Rosling puts it.

Hindalco, Mr Kumar points out, was happy to leave Novelis's senior managers in place. For six months it supplemented them with only two of its own. In 2000, when yet another part of the Tata empire, Tata Tea, bought Tetley, a British rival, it also retained its managers, anxious to preserve their knowledge of local markets.

This forbearance can go too far. In the bad old days of import substitution, Indians coveted any tat from "foreign", just because its origins lay elsewhere. India's corporate shoppers, too, may sometimes show their foreign purchases too much respect. Corus's managers were surprised at Tata Steel's reluctance to reallocate responsibilities and run the two firms as one.

The opposite problem—an excess of patriotism, not xenophilia—may scupper Bharti's deal with MTN. Both India and South Africa take pride in their new multinational champions. Their talks fell through last year when MTN's board argued that it should buy Bharti, not the other way around—a reversal which Sunil Mittal of Bharti condemned as an affront to the "pride of India". But not everyone's pride can be satisfied.

**Chinese firms' foreign investments**

# Sino-Trojan horse

May 28th 2009 | HONG KONG
From The Economist print edition

**Chinese firms are finding new ways to buy access to foreign resources**

THE government of China and the large natural-resources companies it controls have made little secret of their hunger for foreign assets. But using their overflowing coffers to make acquisitions has not been easy. In 2005 America's Congress objected to the efforts of the partially state-owned China National Offshore Oil Corporation (CNOOC) to buy Unocal, an American rival. Chinalco, a state-controlled aluminium firm, has stirred up opposition in Australia with its bid to enlarge its stake in Rio Tinto, an Anglo-Australian mining giant. No wonder big Chinese firms with government ties have been looking for more oblique and less obtrusive ways to expand abroad. A deal unveiled on May 24th, in which PetroChina, another partially state-owned oil firm, will buy a big stake in Singapore Petroleum, a refiner, hints at a new tactic.

Although producers are particularly eager to drum up investors amid the credit crunch and the accompanying sharp fall in commodity prices, national governments are leery about approving outright acquisitions by Chinese firms. One reason is a lack of reciprocity: although China complains about nationalist impediments of the sort that blocked the Unocal transaction, it tolerates little involvement by non-Chinese companies in its own energy industry.

So several recent Chinese investments have taken more roundabout forms. Over the past three months the state-owned China Development Bank has agreed to lend billions of dollars to state-controlled Brazilian and Russian oil firms in exchange for long-term supplies of crude. Meanwhile CNOOC and PetroChina have each done multi-billion-dollar deals tied to the development of specific gas projects in Australia, blurring the line between investments and supply contracts.

The Singaporean purchase appears more straightforward. PetroChina, China's largest energy company, will pay $1 billion for the 45% stake in Singapore Petroleum held by Keppel Corp, a conglomerate in which Temasek, Singapore's state investment fund, owns a big shareholding. The target is not celebrated or strategic enough to occasion much adverse comment, and the transaction appears to enjoy the support of Singapore's government. PetroChina has offered a substantial premium to the stockmarket price. The deal is already the largest in Singapore since 2001 and will probably lead to an offer for remaining 55%. Singaporean bankers and investors, who have been pounded in the recent slump, are thrilled.

But PetroChina has said Singapore Petroleum could serve as a platform for future transactions. That suggests it might try to use the Singaporean firm to pursue the kinds of acquisitions that it would be blocked from making directly. After all, Singapore's own openness to foreign investment, and its record in managing numerous passive overseas holdings, means it is a welcome partner in the rich world. In 2006 a Singaporean investment in Great Wall Airlines, based in Shanghai, apparently helped secure the lifting of American sanctions imposed after the Treasury Department accused its then (and soon after former) parent, China Great Wall Industry Corp, of supplying Iran with missile components.

Yet the benefits PetroChina would receive from having an acquisition vehicle in Singapore would be limited. Concerns still hover around acquisitions by Chinese state-run firms, whether done directly or through a subsidiary, even if the subsidiary is in a friendly country. PetroChina will not be free to invest wherever and however it likes until it is liberated from its controlling shareholder at home.

The bidding for GM Europe

# The fight for Opel

May 28th 2009
From The Economist print edition

**As General Motors prepares for bankruptcy, Fiat and Magna slug it out**

SAVING General Motors' cash-strapped European division from the consequences of its parent's bankruptcy was always likely to prove both complicated and highly political. With GM all but certain to apply for Chapter 11 protection this weekend, the German government was under pressure to move quickly. GM needed to be able to tell the bankruptcy court that a sale of all or part of its Opel and Vauxhall subsidiaries was under way. Angela Merkel's coalition government required a firm basis on which to guarantee bridging loans of €1.5 billion ($2.1 billion) for Germany's second-biggest carmaker by volume, while continuing to work on a longer-term solution that will involve a further €3.3 billion of loan guarantees.

On May 28th the German government had hoped to choose a preferred bidder for Opel, but its deliberations the night before were thrown into turmoil by a last-minute demand from GM for €300m in cash in addition to the €1.5 billion already pledged to keep the car company running.

"This was a bizarre night," Karl-Theodor zu Guttenberg, Germany's economy minister, was reported as saying by Bloomberg. "The talks were turned upside down by GM's unexpected demands."

A final decision was delayed, although the talks did narrow down the choice to two bidders: Italy's Fiat and a consortium comprising Magna International, a maker of car parts that is based in Canada but has roots in Austria, and Sberbank, Russia's largest savings bank. There is unquestionably considerable political support in Germany for the Magna proposal, which is believed to involve fewer job losses than Fiat's. Taking their cue from Opel's powerful unions, the Social Democrats (SPD) in the coalition government have made no secret of their preference for Magna over the Italians, as have at least two of the governors of the four states in which Opel has factories. With a federal election fixed for late September, the SPD is keen to portray itself as the workers' champion at the expense of its coalition partners, Mrs Merkel's centre-right CDU and its Bavarian sister party, the CSU.

But Fiat also has an influential supporter. In direct contact with the German officials on May 27th was a team from America's Treasury, which expects to hold 51% of the equity in a restructured GM when it exits bankruptcy, if all goes according to plan, within the next three months. The Treasury's auto task-force already has a lot riding on Fiat and its boss, Sergio Marchionne, who will take over the running of the "new" Chrysler when it emerges from Chapter 11, perhaps as soon as next week. Given Mr Marchionne's belief that a combination involving Fiat, Chrysler and Opel offers the best and quickest route to success, the task-force and, by extension, GM (at least the parent company in America) did not want to see Fiat excluded from the formal bidding process.

EPA

The outlook remains cloudy

That could be to Fiat's advantage. Although Magna's plan might initially involve the loss of fewer jobs in Germany than Fiat's—Magna says about 2,600, whereas Mr Marchionne talks of 10,000 jobs throughout Europe—it looks a good deal riskier. Building on its experience in car parts and its assembly in Austria of a few fairly low-volume sport-utility vehicles, such as the Mercedes G Class, the BMW X3 and the Jeep Grand Cherokee, Magna wants to use Opel's factories and technology to build cars in large numbers for other companies. By contrast, Fiat's proposal is relatively straightforward. Mr Marchionne sees Fiat and Opel as complementary brands that could share platforms and development costs. With Chrysler, the combined group would have annual revenues of €80 billion from sales of 6m vehicles—the sort of size that Mr Marchionne believes volume carmakers have to become in order to survive.

Talks were due to resume after *The Economist* had gone to press. A possible outcome was understood to

be that both bidders could be given access to management information at Opel. This would allow them to draw up detailed plans. By the time that process is completed, Germany will have gone to the polls and some of the political heat may have been taken out of a decision that will not lie with the German government alone.

## ACS and Iberdrola

# Tilting at windmills

May 28th 2009 | PARIS
From The Economist print edition

**Two of Spain's most powerful businessmen do battle**

FLORENTINO PÉREZ, a construction magnate, is used to having things his own way. As president of Real Madrid from 2000 to 2006 he shipped in a bevy of top football players from around the world, who became known as the *galácticos*, or superstars. Through his company, ACS Group, Spain's biggest builder, which owns large stakes in other firms, he calls the shots in his industry, too. This month, as he announced a bid to return to Real Madrid for a third term, the club's fans cheered, and one newspaper portrayed him as Moses with the sea parting beneath his feet.

But off the pitch Mr Pérez has encountered a seemingly immovable obstacle in the form of Ignacio Sánchez Galán, chief executive of Iberdrola, a utility that is the world's biggest operator of wind farms. ACS, which wants to diversify out of construction into the energy sector, has built up a 12.6% stake in Iberdrola, making it the utility's largest shareholder. That would normally entitle the firm to a seat on the board, but Mr Galán has decided to resist. Late last year, in order to delay any board seat becoming available, Iberdrola abolished the age limit for directors and reduced the maximum number of members from 21 to 15. On May 25th Mr Pérez reiterated his desire to lift ACS's stake to 20% over time and threatened legal action to obtain a seat on Iberdrola's board.

Mr Pérez, who after training as an engineer became a politician in Spain's first democratic government, is well-connected. He has backing from Banca March, owned by the March family, and from other pillars of Spanish finance.

Mr Galán, by contrast, is thought to be unpopular with the current national government because of his refusal to compromise his shareholders' interests—at least, until ACS came along. "He has been the toughest defender of shareholder return against government attempts to direct value in the energy market towards citizens," says one of Iberdrola's biggest institutional shareholders. Mr Gala has won the support of Basque nationalist politicians—Iberdrola's second-biggest shareholder, with 7.2% of its shares, is Bilbao Bizkaia Kutxa (BBK), a savings bank from the Basque region. But Mr Gala does not have the same ties to the political elite that Mr Pérez does.

Much will depend on BBK's stance, says José Javier Ruiz Fernandez, an analyst at Exane BNP Paribas in London. In March the Basque nationalists lost their 29-year grip on the region's government. It is possible that the new political alignment may cause BBK's allegiance to shift to ACS in time, he says. Another shareholder, Bancaja, may be willing to sell its shares in Iberdrola to boost its own cash position, says a shareholder in the utility.

The fight has not benefited either businessman so far. Like many activist investors, Mr Pérez has been caught out by the financial crisis: he bought his shares in Iberdrola, starting in 2006, for above €9 ($11) a share; they are now worth just above €6. His failure so far to secure the board representation means that ACS cannot consolidate Iberdrola's results into its own accounts. And because ACS competes directly with Iberdrola in engineering and in wind power, the utility has a plausible argument, beyond its recent delaying tactics, to keep it off the board indefinitely.

AFP

**Pérez parts the waves**

Iberdrola is also facing questions about its response to ACS. It went on an acquisition spree after ACS first bought shares, buying Scottish Power in Britain for €17.2 billion in 2007 and Energy East in America for €4.5 billion in 2007. Shareholders in the firm now question the timing and prices of these deals. A key aim, they suspect, was to expand the firm to dilute ACS's influence.

Mr Galán may hope that once Mr Pérez wins the Real Madrid presidency

next month, he will be distracted from mere corporate battles. But his arch-rival will once more possess the keys to the presidential box at Real Madrid’s stadium, which he was well-known for stacking with politicians and industrial heavyweights. Keeping him at bay might soon get even harder.

**Cost-cutting in Asia**

# A snip at the price

May 28th 2009
From The Economist print edition

**The recession gives parsimonious innovators a chance to go global**

COBBLED together from carts, old cars and anything else to hand, the improvised vehicles used by Indian farmers are often known as *jugaad*. The term also has a much broader meaning—referring to an innovative, low-cost way of doing something—as goods and services are provided in India at a fraction of the cost of those in developed countries. Ingenuity is a necessity when resources are limited and customers have little money. In a global recession it also provides a way for companies in India and China to expand into foreign markets where consumers are seeking better value for money.

Asia's cost-cutting innovators reject the notion that purchases of certain items only take off when consumers' incomes reach specific levels, says Rama Bijapurkar, a consultant, speaking at a recent conference organised by the Centre for India and Global Business at the Judge Business School in Cambridge, England. Instead of selling items in small quantities to the rich while waiting for everyone else to pass the relevant "income threshold", they re-engineer their products into cheaper ones to unlock mass markets right away.

Anil Gupta, of the Indian Institute of Management, helps run the Honey Bee Network, which encourages grassroots innovation in a number of countries. The projects he has been involved with include a refrigerator built from clay, which uses no electricity yet can help keep vegetables fresh for several days, and a cheap crop-duster in the form of a sprayer mounted on a motorcycle.

Innovation also takes place at a higher level, especially in the growing number of sophisticated research-and-development (R&D) laboratories in China and India. China is already close to overtaking Japan in research spending: over 300 multinationals have opened R&D centres in the country, says Peter Williamson, visiting professor of international management at the Judge school. Many firms began by using Chinese engineers and scientists, who are paid about a quarter as much as those in Europe or America, to adapt products for the local market. But now, he says, they are developing products for world markets.

Alamy

**Watch out, Ferrari**

There are also home-grown innovators such as BYD, a Chinese electronics firm. It has developed lithium-ion batteries that are unusually cheap and easy to make. It has succeeded in reducing costs from $40 a battery to less than $12. Earlier this year BYD's automotive subsidiary unveiled a plug-in electric-hybrid car at the Detroit motor show. Thanks to the firm's cheap batteries, it could sell for about half the $40,000 or so that the Chevy Volt, a plug-in hybrid under development at General Motors, is expected to cost.

Other examples in China include ZPMC and Zhongxing Medical, says Mr Williamson. ZPMC hired a small army of 800 design engineers to produce container-management systems which it customises for individual ports. It has now captured half the world market in harbour cranes. Zhongxing Medical,

borrowing technology from the aerospace industry, has produced an X-ray machine capable of producing digital images directly. Although not as sophisticated as some fancier models sold by Western firms, it is suitable for most routine applications, such as chest X-rays. And it is produced for almost a tenth of what GE and Phillips used to charge for specialised digital X-ray machines, even after those companies cut their prices.

Perhaps the most famous cost-cutting innovator in Asia is Tata Motors, India's biggest carmaker. In March it launched the Nano, which in basic form costs 100,000 rupees ($2,100). A fancier version of the car is expected to be launched in Europe and America in about two years.

India's prolific and low-cost film industry, which churns out some 12,000 movies a year, is also going global. Although Indian films have long had a foreign audience, new co-production deals with Hollywood should increase their reach. Reliance Entertainment, for example, signed a deal with a number of American production houses last year. Rohan Sippy, a Bollywood producer, told the conference that Hollywood studios are keen to do deals with Indian filmmakers so that they can make for themselves cheap song-and-dance "masala" versions of American movies before Indian studios beat them to it. Whether Western firms can truly learn the ways of the *jugaad*, however, remains to be seen.

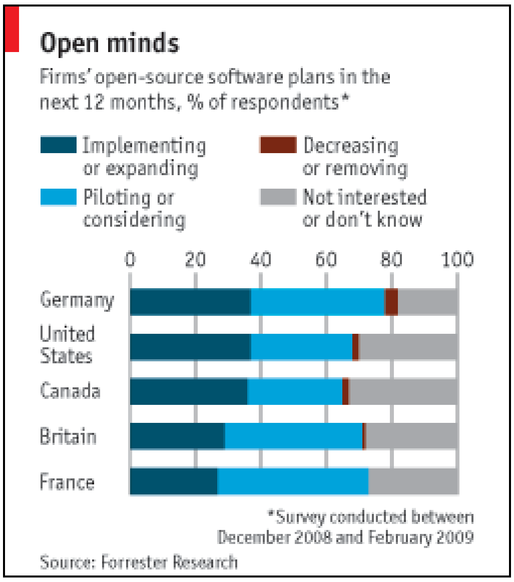
Open-source software in the recession

# Born free

May 28th 2009
From The Economist print edition

**Open-source software firms are flourishing, but are also becoming less distinctive**

MANY technology firms are floundering amid the recession. But many of the ones that offer services tied to open-source software—free programs written by volunteers who collaborate online—are boasting double-digit growth. Sales at Red Hat, the world's biggest independent open-source firm with annual revenues of $653m, grew by 18% year-on-year in the first quarter. More and more firms, particularly in Europe, seem prepared to embrace open source (see chart). "Budgets are tight and we think that is good for open source," said Jim Whitehurst, Red Hat's boss, when announcing the results.




Indeed, open source is so widely accepted that traditional software firms are beginning to dabble in it, while some open-source firms are starting to sell proprietary add-ons to open-source programs instead of charging to provide support to firms using open-source software. If current trends hold, traditional software firms and their open-source rivals will soon be hard to tell apart. "A new pragmatism is rising," says Matt Asay, an open-source advocate and an executive at Alfresco, which makes open-source software that helps firms manage digital content.

The "free and open-source software" movement, as it is officially called, has come a long way from its anti-establishment origins. Pioneers such as Richard Stallman did not want users to be locked into monolithic products, but to be able to change programs in whatever way they wanted, and to share their modifications.

For years, this software commons was no more than an obscure sideshow. But then the internet provided volunteer programmers with a way to co-operate cheaply. IBM and Oracle, two industry giants, threw their weight behind the Linux operating system, in part to weaken their rival Microsoft. After the dotcom bubble burst in 2001, many firms turned to Linux and other open-source software to save money.

Cost is once again the main reason why companies are turning to open source, says Jeffrey Hammond of Forrester Research, a consultancy. Its success is no longer limited to basic software, such as Linux or Apache, a program that powers web servers. Open-source firms are flourishing in databases (Ingres, for instance), business intelligence (JasperSoft), customer-relationship management and other business applications (SugarCRM, Alfresco). In addition, open-source firms have started to move into new markets without proprietary rivals. For instance, a company called Cloudera distributes a version of Hadoop, a program which helps firms process and analyse the unprecedented volumes of data generated by large websites.

But cost is not the only reason for open source's growing popularity. Many firms now know that it offers more flexibility than proprietary programs, the licences for which often include restrictions on how they can be used, explains Matthew Aslett, of the 451 Group, a market-research firm. And companies no longer perceive free software as riskier, he adds. Getting sued for running programs that inadvertently violate somebody else's intellectual property, for instance, has proven not to be as big an issue as once feared. Most open-source firms indemnify their customers against such lawsuits in any case.

All this has led many companies to develop a much more pragmatic approach to open-source software. In the late 1990s installing Linux was often something of a gesture of defiance against Microsoft's domination of the software industry. Today decisions are more rational. The key question is whether the savings in licensing fees for proprietary products outweigh the additional costs in manpower to integrate and operate the free alternative. "Open-source software has become a means to an end," says Forrester's Mr

Hammond. “Most firms don’t really care that it is libre, as in freedom, but that it is gratis, as in beer.”

Open-source firms themselves have also become increasingly pragmatic. Red Hat and Novell, its main rival, still make money by giving away Linux and charging for support: customers sign up for a subscription that gives them the right to all the updates and someone to call if something goes wrong. Yet recent years have seen a flowering of different business models. A popular approach is to sell proprietary extensions to an open-source core. “The support model does not scale well,” Mr Aslett explains. It does not generate the returns expected by venture capitalists, who invested more than $3 billion in 163 open-source firms between 1997 and 2008, according to a study by the 451 Group.

Conversely, having realised that they can economise on resources and garner good ideas, proprietary software firms are increasingly taking a liking to open-source programs, albeit mostly at the edges of their offerings. IBM has sprinkled open-source software throughout its product line and is rumoured to be interested in buying Red Hat. If Oracle’s acquisition of Sun Microsystems goes through, it will have an even bigger open-source portfolio including MySQL, a popular program for databases. Even Microsoft now carefully embraces what its managers once described as a “cancer”.

Cloud computing—the delivery of processing power over the internet from vast warehouses of shared machines—will further blur the lines between proprietary and open-source software. Most of the firms peddling this model, such as Amazon and Google, use open-source software, since having to pay licensing fees would make the business unprofitable. But their services also rely on code developed in-house, which is not given away free. Microsoft, meanwhile, is building a huge cloud using its own software. If computing becomes a service delivered over the internet, it will hardly matter how the underlying software is developed.

Does this mean that the quest for openness in software is obsolete? On the contrary. If they are not careful, companies and consumers could get locked into a cloud even more tightly than into a piece of software. This is because data residing in the cloud can be hard to move to another service. “If you have a gigabyte somewhere, it develops a certain inertia,” says Mike Olson, the boss of Cloudera, which recently found it could not switch from a poor storage service because there was no way to move the data.

This sort of problem has spawned an open-data movement. In March a group of technology firms led by IBM published an “Open Cloud Manifesto” that has since received the support of more than 150 companies and organisations. It is only a beginning, but perhaps this time around the industry will not have to go through a long proprietary period before rediscovering the virtues of openness.

**Face value**

# Ding dong! Empowerment calling

May 28th 2009
From The Economist print edition

**Andrea Jung is determined to use the recession to boost the fortunes of both Avon and its saleswomen**

Eyevine

ON THE wall behind the desk of Andrea Jung, the boss of Avon, a beauty company, hangs a plaque labelled “The Evolution of Leadership”. It displays four footprints: that of an ape, then a barefoot man, then a man’s shoe and finally a high-heeled shoe. It is a symbol both of Avon’s self-proclaimed mission to empower women and of Ms Jung’s own high-heeled ascent to the corner office.

Appropriately enough, Ms Jung first saw the plaque hanging in the office of James Preston, the previous boss of Avon, when she was interviewed for a job at the firm in 1993. She asked him whether he believed there would ever be a female chief executive of Avon, which had never had one. He said there should be. What is more, he offered her a job (and gave her the plaque when she became chief executive). The belief that Avon would do well by its female staff is one of the reasons Ms Jung joined the firm, the world’s biggest direct seller, with revenues of $10 billion annually and operations in more than 100 countries.

Ms Jung is quick to point out that Avon offers opportunities to women in humbler positions as well. It employs 9m sales representatives, more than 95% of whom are women, to sell its products for a commission, mainly by door-to-door hawking. Around 70% of Avon’s sales are in developing countries: Brazil, Russia and Mexico have become Avon’s largest markets after America. Saleswomen in those countries are attracted by the potential earnings and by the loans Avon offers to help new representatives get started. The income, she says, can be significant by local standards. The job is particularly attractive to women who want to work more flexible hours, achieve financial independence or run their own business. Ms Jung takes Avon’s image as a friend to women very seriously. She changed the firm’s slogan from “Ding dong! Avon calling” to “The company for women”. And Avon donates lavishly to women’s causes, including campaigns against breast cancer and domestic violence.

Ms Jung’s life story is just the sort of inspirational tale that Avon’s sales representatives would like to hear. She is the daughter of Chinese immigrants who moved first to Canada and then to America. They spoke little English, but she managed to get into Princeton and graduate with honours. She then started her career at Bloomingdales, an upmarket department-store chain. She did stints at several ritzy retailers, including I. Magnin and Neiman Marcus, before starting at Avon.

But Ms Jung’s career has not been without its setbacks. She was passed over in 1996, when she first competed for the job of chief executive, receiving the number two spot instead. Nor has everything gone

smoothly since she at last became boss two years later. After six consecutive years of double-digit growth, the firm’s fortunes took a dramatic turn for the worse in 2005. Sales declined in key markets, and Avon’s share price plummeted.

“You have to go home tonight, Friday evening, and you’ve got to fire yourself,” a management coach told her. The intention was for her to come to work the following Monday as if starting the job anew. In the end, she decided it was others who had to go: she eliminated seven layers of management to improve efficiency, dispensing with more than 25% of senior staff. Although she cut costs in most areas, she decided to spend more on distribution and advertising. That difficult episode, she says, taught her to have a “constant turnaround mentality”. She now seeks out sales representatives and senior management to hear their criticisms of the company and their ideas about what Avon should be doing differently “even when the sun is shining”.

Ms Jung thinks the current recession offers Avon a “seminal” opportunity to stand out among the cosmetics giants. Other beauty companies, like Estée Lauder, are struggling because of consumer cutbacks amid the recession. But low prices (many of its products cost less than $10) and a unique distribution channel make it easier for Avon to cope with the adverse conditions. By relying on a grassroots sales force, Avon has been able to reach new buyers, particularly in places like China and Brazil where many people live far from any shopping malls. Avon has also modernised the way it does business, for example by creating platforms for sales representatives to sell products online. In March Avon launched the biggest hiring drive in its history, spending roughly $400m on advertising that promotes Avon as a potential career for people recently laid off. It has been recruiting vigorously online, at job fairs and outside unemployment offices. It has also nearly doubled its marketing budget.

## Time for a makeover

All this might be working. Profits fell in the first quarter from a year earlier, but by less than those of many rivals. Around 1m new sales representatives have joined Avon since the beginning of last year, attracted by its message of job security in these lean times. In March the number of new sales representatives was up 47% in America compared with the previous year and 148% in Mexico, for example. Past recessions have led some in the industry to hypothesise that lipstick sells well in hard times because women substitute small luxuries for bigger ones, though statistical evidence for this claim is lacking. In Avon’s case, its performance really does seem to be aided by another counter-cyclical correlation: the number of those eager to work in beauty appears to rise sharply as unemployment goes up.

There are still plenty of difficulties in store for Ms Jung. It will be hard to train so many new representatives and to retain them once the global economy rebounds. One industry analyst thinks investors do not yet have full confidence in her again after the problems the firm experienced in 2005. And Ms Jung’s compensation increased almost 76% in 2008, to over $19m. Given the sour public mood about executive pay, some investors may consider such a rise empowerment run amok.

Economist.com OPINION

Restraints on executive pay

# Attacking the corporate gravy train

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From The Economist print edition

**The global downturn has sparked outrage over executive compensation. Only some of it is justified**

Illustration by Jason Ford


EARLIER this month Iain Coucher did something rather unusual for a chief executive. Mr Coucher, the boss of Network Rail, which is responsible for Britain's railway infrastructure, announced that he did not want an annual bonus this year, even though he had pocketed one worth £306,000 ($614,000) in 2008. The reason for such selflessness? Mr Coucher said he was "mindful of current sentiment" and wanted to avoid an outcry that would overshadow his firm's achievements— although he is hanging on to a potentially lucrative long-term bonus plan. Britain's transport minister, Lord Adonis, heaped praise on Network Rail's boss for his "responsiveness to the public mood at this time of economic hardship".

That mood has turned very ugly indeed, and not just in Britain. In many countries popular resentment at Croesus-like pay packages for chief executives has prompted critical headlines and a loud chorus of complaint from politicians. Although bankers have been the targets of the sharpest barbs, plenty of bosses in other industries are also getting a tongue-lashing. When Valeo, a troubled French car-parts supplier, awarded a €3.2m ($4.4m) payment to its departing chief executive in March, France's prime minister, François Fillon, lambasted the decision. "The time has come to show responsibility," he thundered, "and those who do not show responsibility put our entire social and economic system at risk."

Politicians are not the only ones getting hot under the collar. So, too, are some big investors. On May 19th the directors of Royal Dutch Shell received a stinging rebuke when 59% of voting shareholders rejected a pay deal for the oil giant's senior executives. The vote was not binding, but it was highly embarrassing for Shell's board, which had decided to hand over shares as a bonus to managers even though the firm had missed performance targets.

Faced with public outrage over what they consider to be unbridled executive greed, many governments are preparing new rules to rein in pay. Most of these measures will be aimed at companies that have been rescued at taxpayers' expense. For instance, America's treasury secretary is due to unveil guidelines on pay for companies that have received aid under the government's Troubled Asset Relief

Programme (TARP). But some plans have a broader sweep. The German government has put forward a draft law which is aimed at all publicly quoted companies and which includes provisions that would force executives to hold share options for at least four years, instead of two. The German proposal would also require all members of a board, rather than just a subcommittee, to sign off on matters of pay.

All this political interference in what companies decide to pay their executives raises two important questions. Is the process for setting bosses' pay broken? And if it is, what should be done about it?

## From payday to mayday

There is now little doubt that pay was a contributory factor in the banking industry's meltdown. Accustomed to fat annual bonuses that were multiples of their base salaries, many bankers had little reason to dwell on the risks associated with the deals that they were signing. Even some of the industry's leading lights, such as Lloyd Blankfein, the head of Goldman Sachs, have publicly acknowledged that the incentives such schemes created helped send the industry plunging into an abyss.

Banks are rejigging their compensation plans in response to make base salaries a bigger percentage of overall compensation. On May 22nd Morgan Stanley's board approved a hefty increase in the base pay of several senior executives, including its two co-presidents, whose salaries are rising from around $300,000 to $800,000 a year. The firm also said it was raising the base salaries of several other categories of executive. Other banks are likely to follow its lead. They are also bringing in clawback systems that allow them to recover some or all of bonuses if the deals on which these were based subsequently turn sour.

One person at Morgan Stanley who did not get a rise in salary was its boss, John Mack, whose base pay will remain at $800,000 a year. Like many other chief executives, Mr Mack has a mountain of equity-related incentives that are supposed to ensure that he takes a long-term view of his company's fortunes. But in spite of such holdings, some chief executives, such as Dick Fuld at Lehman Brothers and Jimmy Cayne at Bear Stearns, let their firms take huge risks and then paid the price when the value of their shareholdings evaporated.

What went wrong? With hindsight, it is clear that the industry's leaders collectively failed to understand the nature of the risks their firms were taking on. But Lucian Bebchuk, a pay expert at Harvard Law School, sees another problem. He points out that equity-based bonus plans align bankers' interests only with those of shareholders. This encourages them to make big bets that could dramatically increase the value of a bank's shares. But if those bets go wrong, then it is not just shareholders who end up shouldering the catastrophic losses; they are borne by unsuspecting bondholders and taxpayers too. To solve this problem, Mr Bebchuk recommends linking bankers' fortunes not just to share prices, but also to, say, the price of credit-default swaps on a bank's bonds.

Although such a market-based approach is attractive, the American government seems bent on regulating banking pay more tightly. The good news is that it appears to have dumped the daft idea of imposing pay caps on banks, which would simply have driven talented people out of the industry. But there are still grounds for concern. The TARP rules seem to imply that executives of firms receiving money from the government will not be allowed to pocket any long-term incentives until their firm has paid it back. This could result in some banks seeking to quit the programme before they are fit enough to do so.

Strict limits on performance-related pay at banks could also do more harm than good. One reason American business has thrived for so long is that its leaders have had a stronger incentive to perform well than those of other countries (see chart 1). Limiting the ability of financial institutions to pay sensible bonuses will simply prolong their woes. Edward Liddy, who was brought in to run American International Group (AIG) after the ailing insurer was rescued by the government, recently gave warning that executives cannot be expected to toil 24 hours a day without being adequately compensated for doing so. Mr Liddy, who plans to leave AIG once a successor has been found, cut his base salary to $1 a year in November 2008 following howls of protest over the pay of bosses at firms that had received bail-outs.

## Corporate lapdogs


Some critics claim it is not just banking that has a pay headache. They argue that many bosses in other industries are overpaid because weak boards have allowed them to dictate the terms of their compensation. As a result, pay bears little relationship to performance and tends to rise inexorably. A chief critic of the supposed corporate gravy-train is Warren Buffett. At the annual meeting of his holding company, Berkshire Hathaway, on May 2nd the legendary investor railed against a system that lets chief executives choose the members of remuneration committees. This, he claimed, allows them to select compliant directors prepared to wave through pay proposals. "These people aren't looking for Dobermans," he complained. "They're looking for cocker spaniels."

Investor protests such as the one at Shell appear to support the thesis that boards are a soft touch. So does the proliferation of perks enjoyed by some bosses, especially American ones. One of the most controversial of these is the so-called golden coffin, under which the heirs of a chief executive can collect severance-style death benefits, such as unvested share options, if the boss suddenly dies. Shareholder activists in America have been trying to bury such coffins for good this year, but without much success.

A big problem, they say, is that too many institutional investors are willing to rubber-stamp pay plans. A recent study by the Corporate Library, a research firm, reviews the proxy-voting trends of 26 large American mutual funds on pay-related matters. Entitled "Compensation Accomplices: Mutual Funds and the Overpaid American CEO", it shows that the average level of support for management proposals on pay rose from 75.8% in 2006 to 84% last year. Manifest, a European shareholder-advice firm, says 97% of all shareholder votes cast in Europe last year were supportive of management.

Activists claim such studies prove that shareholders are asleep at the till. But another explanation for the results is that the current system of setting bosses' remuneration is in better shape than Mr Buffett and others believe, and that shareholders are, by and large, happy to support it. Although some outrageous pay deals do get waved through, there is evidence that the pay-for-performance model is functioning reasonably well and that boards have more clout than Mr Buffett seems to think.

Start with the link between compensation and profitability. If boards really are in the pockets of chief executives, then it seems unlikely that bosses would let them reduce their pay. Yet many European companies have been slashing senior executives' compensation as their profits have plunged. In April, for instance, Bosch, a German engineering giant, said that remuneration for its top-ten senior managers fell from €18m in 2007 to €13m last year, and that their pay had been frozen for 2009. American bosses are also feeling the pinch. According to Towers Perrin, a consultancy, data from American firms that had filed their 2008 proxy statements by the end of March show that, although median base-salaries rose slightly, the median annual bonus fell by 19%. Another sign of pay for performance being a reality is that bonuses fell the fastest in those industries which experienced the steepest fall in profits. In a separate study of 135 public companies' compensation reports, the consultancy concluded that over half were planning either to freeze or reduce salaries in 2009.

Long-term awards are also falling. Another consulting firm, Hewitt, looked at share options and other such rewards granted by big American companies to executives between December 2008 and April 1st 2009. It concluded that the median decline in their value compared with the set of grants made in the previous year was 20%. And it noted that the firms that had made the biggest cuts were those whose share prices had fallen the most.

There are other signs of the market at work. "Boards of directors are more responsible than people give them credit for," says Stephen Fackler of Gibson, Dunn & Crutcher, an American law firm. He points out that more companies are moving away from awarding share options and towards issuing performance-based restricted shares. These typically vest after a certain time only if a company has both increased value for its shareholders and performed well against a peer group.

All this suggests that even in America, the land of the superstar chief executive, boards are not bosses' poodles. In a paper entitled "Embattled CEOs" published in October 2008, Marcel Kahan of New York University's School of Law and Edward Rock of the University of Pennsylvania Law School argue that

bosses have in fact been losing power steadily to boards of directors and shareholders over a number of years. One reason for this is the rise of activist hedge-funds, which target underperforming firms and lobby directors to improve their returns. Another is the growth of influential shareholder-advisory outfits, such as RiskMetrics and Glass Lewis, which scrutinise firms' activities, including pay plans, and make recommendations to clients on how to vote their shares.

Regulatory actions have also encouraged boards to get tougher on pay. For instance, Messrs Kahan and Rock note that new stockmarket regulations in 2006 forced companies to publish the various components of a chief executive's pay and to justify them. These and other changes may explain why Steven Kaplan, a professor at the University of Chicago's Booth School of Business, has found that median pay awards to bosses in America—comprising base salary, bonus, restricted shares and the expected value of share options—stayed roughly flat between 2000 and 2007, at around $8m a year. Bosses may ultimately have pocketed much more than that thanks to buoyant markets, but it appears that boards have not been deliberately inflating their potential earnings.

Illustration by Jason Ford

Although the pay system is not broken, parts of it are badly in need of repair. One example is severance payments that appear to reward executives for failure. Strange as it may seem, the principle behind these is sound: managed well, they give bosses an incentive to fess up to serious problems rather than trying to disguise them for as long as possible. That ultimately benefits shareholders. But some payouts are a lot more generous than they need to be. Boards should also take a hard look at many perks, such as golden coffins, that crept into contracts in boom times, but have nothing to do with performance.

Some experts give warning that reform needs to happen fast if the pay-for-performance system is to be preserved. "There is a real danger that we will lose the freedom to use pay as a force for good," says Sean O'Hare, a partner at PricewaterhouseCoopers. That risk might not yet have sunk in to every occupant of a corner office. Ira Kay, the head of the compensation practice at Watson Wyatt, a consulting firm, says that although many boards have embraced the need for change, some executives are still resisting because they think the fuss over pay will soon blow over.

## Paid if you do, paid if you don't

That may give governments an excuse to act. Australia, for instance, has floated plans to force firms to get shareholder approval for any severance packages bigger than a chief executive's annual base salary. Yet politicians' attempts to meddle with pay have often backfired. America provides a cautionary tale. In 1984 the government tried to cap severance payments at three times base pay by imposing a special tax on any payments above that level. But the multiple of salary quickly became a starting-point for new deals and companies agreed to cover the tax that bosses incurred on more generous arrangements. Then in 1993 a $1m cap was imposed on the tax deductibility of executive salaries. This had two unintended consequences: salaries underneath $1m quickly rose to that level and firms promptly showered their bosses with share options and other forms of pay that were not covered by the limit.

So what, if anything, should governments be doing now to address the issue of pay? The main thing is further strengthening the ability of shareholders to monitor and influence compensation deals before they are signed off. That way, cases of abuse can be dealt with swiftly. A step in the right direction was recently taken by America's Securities & Exchange Commission, which has proposed a new rule that would make it easier for investors to nominate directors to corporate boards.

America should also make “say on pay” votes by shareholders mandatory at public companies. Although such votes are not binding, they do force boards to justify compensation policies regularly and can be a useful channel for expressing displeasure if something does not feel right, as Shell has just discovered. Common in Europe, the votes are not required in America at present, except at companies that have tapped the TARP. Nevertheless, investors there can lobby for votes to be held at any publicly quoted firm and the number of requests for say-on-pay ballots in America has been rising steadily (see chart 2).

Charles Schumer, a Democratic senator, has just introduced a bill in Congress that would, among other things, force all public companies to submit their pay policies to a vote. Some firms reckon this would be an annoying distraction. They also fret that special interests, such as public-sector pension funds, will abuse the system to further their political agendas. But the track record from Europe shows that what say-on-pay tends to do most of all is encourage a better dialogue between shareholders, managers and boards on pay-related matters ahead of votes.

Expect more examples of corporate greed to surface in the coming months. Although these will be exceptions rather than the rule, they will almost certainly increase populist pressure on governments to meddle in the market for top-level executive compensation. If politicians respond by issuing ill-conceived rules on pay that strangle the entrepreneurial spirit, the only thing that will end up getting derailed is a global economic recovery.

Overhauling financial regulation

# The regulatory rumble begins

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From The Economist print edition

**In America and Europe, new rules are already running into stiff resistance—mostly from regulators themselves**

Illustration by S. Kambayashi

"YOU want to move at the point where people still have the memory of the trauma," Tim Geithner explained recently when asked about financial regulation. Aware that the crisis is moving into a new phase, with the emphasis shifting from firefighting to working out how supervision should be restructured, America's treasury secretary wants to seize the moment. He plans to unveil a comprehensive regulatory overhaul by mid-June. Barack Obama has said he wants to sign the changes into law by the year's end.

In Europe, too, the pressure is on. "There's no room for more delays," José Manuel Barroso, president of the European Commission, said on May 27th when he unveiled a blueprint for reform of financial supervision. He announced plans to form two new grandly named institutions: a European Systemic Risk Council, which is supposed to provide early warning of possible risks, and a European System of Financial Supervisors, which would be a super-committee of regulators from across the European Union.

The goals of the two new institutions are admirable. Both are intended to correct a fundamental flaw in European bank regulation and supervision; namely, that although banks are free to operate across borders, they are supervised only by their home countries. Slack oversight by one country can, as the crisis has revealed, spread chaos across many. Yet it is not at all clear that the proposals have been thought through properly. "The European Commission is confusing speed with haste," says Nicolas Véron of Bruegel, a think-tank in Brussels. "The governance, mandate and funding of these new authorities is not really addressed." Britain, which has the biggest banking centre, is particularly concerned about the proposed rules, which may cede aspects of the City of London's banking supervision to Brussels.

In America, meanwhile, the plans taking shape face resistance, partly from the bankers they will shackle but even more from regulators and lawmakers. Bankers accept they will be forced to build up bigger capital buffers, which will crimp profitability, and that the liquidity of their balance-sheets will be policed more intensively. The regulatory net will be cast over the "shadow" banking network of hedge funds, money-market funds and the like, to which much financial activity gravitated during the boom.

Big banks, however, still have enough lobbying power to ensure that not every decision goes against them. True, they are still licking their wounds after the recent passage of draconian credit-card reforms.

But they are happier with the government's proposals on derivatives, under which dealers will be able to continue peddling customised swap contracts away from exchanges, albeit with a higher capital charge.

As the crisis has deepened, American bankers have tempered their opposition to the idea of new rules that reduce the chances of another blow-up. "Would I accept regulation that slows innovation a bit and knocks three percentage points off my returns if it promised greater stability? Absolutely," says the head of one large bank.

For some, more stringent regulation even has a silver lining. With tougher mortgage rules, banks will no longer have to lower their standards to compete with the industry's unregulated parts. The survivors could also benefit from higher barriers to entry.

On the whole, Wall Street sees a welcome disconnect between the Obama administration's rhetoric and its actions. The Treasury is "gradually learning" how to square the circle of showing that it understands the public's anger on the one hand, and maintaining a dynamic financial sector on the other, says one bank lobbyist. Another test of its capacity to resist pitchfork-wielding urges will come in the next few weeks, when it is expected to issue guidelines on executive pay.

The stiffest resistance to change is coming not from Wall Street but from Washington, DC, where government officials, regulators and congressional leaders are locked in turf wars and ideological battles. "Opinion has splintered. Everyone is fighting everyone," says Bert Ely, a consultant on regulatory issues.

Even the main banking agencies are at odds with each other. Sheila Bair of the Federal Deposit Insurance Corporation (FDIC) and John Dugan, the Comptroller of the Currency, have fallen out over Ms Bair's deposit-insurance reforms. Mr Dugan also opposes the FDIC's push for sole authority to liquidate failing non-banks, as it already does with banks.

Worse, there is no consensus on the proposed systemic-risk regulator, which would identify and act on emerging "macro-prudential" dangers. The administration wants the Fed to assume the role, but many in Congress oppose this. Dick Shelby, an influential senator, has accused Mr Geithner of using the crisis to hand the Fed unacceptable levels of power. Meanwhile, Ms Bair has suggested that systemic regulation be done (or at least overseen) by a multi-agency council, an idea that is gaining traction even if others (including, again, Mr Dugan) worry that such supervision-by-committee is a recipe for inaction.

An even bigger battle is brewing over the shake-up of existing regulators. No one doubts that the archaic, overlapping patchwork of agencies needs modernising, with regulation refocused on a firm's activities rather than its legal form. Reportedly, the White House is considering rolling the four banking-supervision agencies into one, though the idea is still in flux.

But an embryonic plan to create a super-regulator for consumer products, such as mortgages, credit cards and mutual funds, is already encountering stiff opposition. The Securities and Exchange Commission (SEC), which would lose out in such a shuffle, has powerful friends on Capitol Hill, especially on the Senate banking committee that oversees the agency—and any overhaul would require congressional approval. Public pension funds have also joined together to lobby against a reduction in the SEC's power.

Moreover, the economically rational may not be politically feasible. Though it would make sense to merge the SEC with the Commodity Futures Trading Commission, which regulates derivatives, Congress's powerful agriculture committee would probably block the move.

Debate about other thorny issues, such as what restrictions to place on, or whether to dismantle, banks that are too big to fail has barely begun. Congressional leaders cannot even agree on whether to pass new rules in pieces or roll them up into one mega-bill.

All of which explains why pundits now expect to see few, if any, further financial reforms passed in 2009. Delay could play into the financial industry's hands, to the extent that it reduces the likelihood of heat-of-the-moment laws like Sarbanes-Oxley, rushed through after the Enron scandal. But if measures that would increase stability fall victim to politics, everyone will be worse off.

Economist.com FINANCE & ECONOMICS

**Buttonwood**

# Not so risk-free

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**There are questions about the long-term appeal of American Treasury bonds**

Illustration by S. Kambayashi


LIKE London buses, big events in America's Treasury market all seem to come at once. In a week when the Treasury auctioned more than $100 billion of notes and bonds, ten-year Treasury yields surged to their highest level in six months, despite a buy-back offer by the Federal Reserve. That will raise the cost of finance for companies and homeowners.

All this activity was inevitable once the authorities decided to combine a huge fiscal deficit with quantitative easing (expansion of the money supply). It has been accompanied by a sharp rise in the gap between short and long rates. The ten-year yield has risen from 2.08% on December 18th to 3.70% on May 27th.

Some of that rise in yields is undoubtedly due to investors switching back into shares on hopes that the global recession might end next year. But there have also been concerns about America's long-term financial health. On May 27th Moody's said it had no plans to reduce America's coveted AAA debt rating. But on the same day John Taylor, a professor at Stanford University and the creator of the Taylor rule on monetary policy, wrote in the *Financial Times* that the American government "is now the most serious source of systemic risk."

On the surface, the worries seem odd. Is America likely to default on its obligations? No. To put it another way, if the world ever got into a state where America did prove unable to pay, lots of other assets would have defaulted first. Even though the American budget position is deteriorating rapidly, it is still a lot healthier than that of either Italy or Japan. Both countries have been carrying debt/GDP ratios of more than 100% for years without suffering a meltdown.

Government bonds are generally regarded as risk-free in their home countries, because the government has the power to tax and to print money. Since America is the world's largest economy, has the most liquid financial markets and operates the world's premier reserve currency, the Treasury bond has been seen as the global risk-free asset.

But that status implicitly rests on the belief that the American government will not exploit its advantages to the full. The same fiscal and monetary policies that seem appealing as a way of addressing domestic economic weakness also reduce the appeal of its debt to foreign investors.

America does not formally need to default to penalise its creditors; it can simply let its currency decline. Short-dated Treasury bonds (those with a maturity of one-to-three years) have returned a healthy 18% in dollar terms over the last three years. But when translated into Chinese yuan that return dwindles to just 0.3%.

History is full of examples of sovereign nations failing to pay their overseas creditors in full. When push comes to shove, governments are unwilling to impose the required level of austerity on their voters. This happened in the 1920s Weimar Republic, which opted for hyperinflation rather than paying the reparations bill, and in 1930s Britain, which abandoned the gold standard in the face of the Depression. (Note the results of the recent referendums in California, where voters rejected all budget-balancing proposals.)

In countries that are frequent offenders, including those in Latin America, foreign creditors have in the past demanded that government debt be denominated in a foreign currency. America has been able to borrow in dollars. However, for foreign investors, that means Treasury bonds are not risk-free at all.

Even domestic investors might reflect on the potential for inflation to erode the real value of their holdings. Inflation-adjusted, the capital value of Treasury bonds fell by more than five-sixths between 1962 and 1981.

Inflation-linked government bonds ought thus to be a more appropriate risk-free asset than conventional bonds. Foreign investors might calculate that, over the long run, a dollar decline would be matched by higher inflation, for which they would be compensated. However, the index-linked market is a lot less liquid than that for conventional debt. And cynics might wonder whether governments will really meet their obligations when faced with runaway inflation, rather than finding a way to "redefine" the statistics.

So what might replace Treasury bonds as the global risk-free asset? Some would opt for gold, although it pays no yield and its nominal value is highly volatile. China has no asset that seems appropriate. What about German government bonds? Fiscal policy is relatively prudent and the European Central Bank seems far more committed to fighting inflation and maintaining a stable currency than other monetary authorities.

**Lloyd's of London**

# Eggs and baskets

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From The Economist print edition

**After AIG, firms buying insurance are keener to spread their risk. But how?**

Rex Features

Spelling is not the only improvement

WHEN American International Group (AIG), the world's biggest, meanest and supposedly safest insurer, collapsed into the government's arms in September 2008, there must have been a few cheers from its rivals. Many hoped to win its customers, particularly large firms paranoid about having high exposure to one (dodgy) counterparty. It also seemed possible that the model for insuring companies' big risks—buildings or a mine, for example—might change. Instead of placing them with a few insurers, it might be better to syndicate out those risks to many, not least through Lloyd's, the insurance market founded in a London coffee house in 1688.

Eight months on, the revolution has yet to arrive. There has been no stampede of corporate customers from AIG, says Andrew Rear of Oliver Wyman, a consultancy. Loyalists reckon this reflects the fact that its insurance operations were safely ringfenced from its kamikaze derivatives adventures. Sceptics point out that since the bail-out it has the backing of a government that (for now) retains a AAA credit rating. Yet despite AIG's refusal to die, the instinct of customers to diversify is still alive. Sally Bramall of Willis, an insurance broker, says that big insurers are no longer assumed to be safest or best, and that clients are prepared to put their eggs in more baskets.

How they do this is, however, less clear. One possibility is that traditional subscription markets do better, most noticeably Lloyd's. There, the end customer enlists a broker to place his risk among multiple syndicates (which are, in turn, often dominated by outside insurance firms). The customer gets a single contract, but the potential losses are spread. And because the market is partly mutually owned, the customers have the security of both syndicate members' capital and, as a last resort, a shared cash pool funded by all members.

Mark Gregory, chief executive of Bowring Marsh, a unit of insurance broker Marsh, says clients particularly admire the skill of Lloyd's underwriters at dealing with unusual and complex risks (try Ugly Betty's smile). Most observers note its improved risk management too, which should prevent individual syndicates from losing their discipline, or falling victim to the "herd mentality" that one industry veteran says is Lloyd's' historical weakness.

Furthermore, even by the relatively hygienic standards of most insurers, the asset side of Lloyd's' balance-sheet is squeaky clean, while the toxic claims that brought it to its knees in the 1990s are now parcelled off to Warren Buffett's Berkshire Hathaway. And, for the customer, the benefits of having a single contract with one set of wording and terms should not be underestimated. After the September 11th terrorist attacks, some insurance companies, which had written slightly different contracts, disputed whether one or two events had occurred, says Chris Hitchings, an analyst at Keefe, Bruyette & Woods.

Yet for all that, a big shift towards subscription markets does not seem imminent. In part that reflects the relative lack of scale of Lloyd's. Europe's leading insurance companies rival it in terms of non-life premiums written and balance-sheet oomph. Such firms' big books of business should allow their customers to benefit from diversification. And just in case they "do an AIG", there are other ways to spread risk. Brokers already take big bits of business and split them between individual companies, Lloyd's and other markets such as Bermuda (where rather than using a subscription model, the lead insurer often subcontracts risk to peers). In future many clients may just instruct their brokers to divide up the business even more—and sort out the resulting complexity.

Economist.com FINANCE & ECONOMICS

China's dubious earnings numbers

# Red flags

May 28th 2009 | HONG KONG
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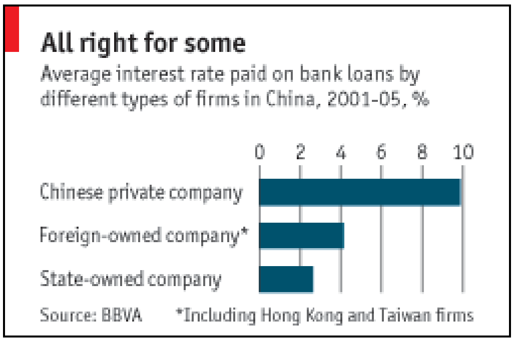
**Investors appear to have little faith in company accounts**

CHINA'S stockmarket has been one of the best performing in the world this year, and the country's firms have so far steered through the global financial crisis better than many of their global peers. Partly they may have been buoyed by robust business conditions in China. But two recent studies, which raise serious questions about the credibility of China's corporate earnings, suggest that companies may also have had an artificial boost.

The less damning of the two is issued under the auspices of the Hong Kong Monetary Authority and written by Giovanni Ferri, of Italy's University of Bari, and Li-Gang Liu of BBVA, a bank. It argues that the profits of China's large state-owned companies are entirely a product of subsidised financing by state banks, which lets them borrow much more cheaply than private or foreign firms (see chart).




To reach that conclusion the authors sifted through government data from 1999-2005. Mr Liu believes that such subsidies may have even increased since last summer, because the big state-owned enterprises have been the main beneficiaries of China's economic stimulus. In the short term the subsidies will have boosted profits, not least compared with the firms' credit-starved private peers. But in the longer term Mr Liu believes that the political component of the loans will mean capital is being allocated inefficiently, raising the prospect of future losses.

At least the academics are convinced that the profits are genuine, even if they are subsidised. But an exhaustive working paper by TJ Wong and Danqing Young, of the Chinese University of Hong Kong, and Xianjie He, of Shanghai University of Finance and Economics, reaches a more alarming conclusion. It suggests investors have little faith in the numbers.

To measure this they looked at Chinese firms before and after the country broke with its accounting traditions in 2007, adopting something akin to international accounting standards, which base valuations on market prices. They then dissected earnings in three ways. First, they compared how shifts in earnings correlated with shifts in share prices under the old accounting system and the new. An improvement in accounting practices should have meant a closer correlation between earnings and the performance of the share price. Not only did this not happen—there were some signs that things got worse.

Nor were there correlations between the share price and the shift in reported value of investment instruments, goodwill and the impairment of assets—all typically critical to an investor's analysis. Lastly, the academics examined a nuance in the new standards that allowed Chinese firms to book profits by restructuring debt that was owed to affiliated companies. Before the change in accounting standards, this kind of debt restructuring was rare. Afterwards, it was common: more than 200 companies, or over 15% of those in the study, did it in 2007. This resulted in clear gains to earnings but no impact on share prices. So is there anything in the company reports that investors do consider to be meaningful? That, says Mr Wong, is the subject of the next study.

**Headaches for a hedge-fund manager**

# Good gRIEF

May 28th 2009 | NEW YORK
From The Economist print edition

**A brilliant investor has trouble replicating his success**

"LUCK", James Simons, the founder of Renaissance Technologies, a hedge fund, once said, "plays a meaningful role in everyone's lives." Mr Simons, a 71-year-old former university professor and a celebrated mathematician, has been blessed with the stuff. His flagship fund, Medallion, has had average annual gains of more than 35% for 20 years. Last year he was named the best-paid hedge-fund manager in America by *Alpha*, a hedge-fund magazine, reportedly earning $2.5 billion. Medallion gained 80% last year, and this year is up a further 12%.

But Medallion is 98% employee owned and has not accepted new money for 15 years. So to cater to outside investors, Renaissance has since 2005 marketed another "mega fund" known as the Renaissance Institutional Equities Fund (RIEF). The problem is that this has not proved anything like as successful as Medallion. Before its launch a small army of Renaissance PhDs—there are more than 70 on the payroll—back-tested RIEF's performance with a simulated portfolio of $100 billion. From 1992 to 2005, its theoretical return was more than double that of the S&P 500, with less than two-thirds of the volatility. Investors queued up like Trekkies waiting for tickets to the new film.

In the first two years RIEF raised more than $1 billion a month. With new money coming in faster than it could be invested, monthly contributions were capped at $1.5 billion. By August 2007 the fund was managing almost $28 billion. But in 2008 RIEF lost 16% and investors withdrew $12 billion from Renaissance, which was the largest prime-brokerage client of both Bear Stearns and Lehman Brothers, two investment banks that failed. The downward spiral has continued this year, with RIEF losing 17% so far. It now has less than $10 billion of assets under management.

Mr Simons explains the lopsided returns by saying that the two funds approach investing in different ways. Medallion attempts to identify "predictive signals" in the market. Its high-powered computers are programmed to profit from split-second price distortions. RIEF moves much more slowly. Most positions are held for a year. Like Medallion, it uses computers to buy and sell stocks. The fund is designed to provide investors with smooth returns, the success of which is measured against the S&P 500.

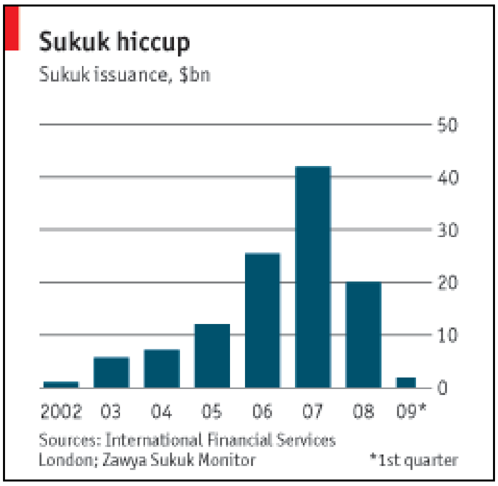
It has, in fact, beaten the S&P 500 by almost 4% a year since inception, but it has also trailed behind an index of its peers. In general, computer-driven funds are becoming less popular with investors. But Mr Simons is RIEF's biggest investor, which gives him every reason to want to improve its performance. This could be the biggest lesson of the whole episode. Though investors may think they are seduced by the wizardry of Renaissance's computer-driven models, what they are really betting on is the magic touch of the man himself.

**The Gulf's nascent bond market**

# Crisis and opportunity

May 28th 2009 | MANAMA
From The Economist print edition

**A market for Islamic and conventional bonds is stirring**




AFTER the 1997 Asian crisis Malaysia, bruised by what its government saw as the buccaneering spirit of Western capitalism, threw itself into Islamic finance with renewed vigour. Bahrain hopes to follow a similar path. The credit crunch did not come a moment too soon, as far as Manama was concerned. It has breathed new life into a regional market for bonds—both Islamic and conventional ones—and Bahrain has ambitions to be a hub for issuance and secondary trading. “We really needed a crisis like this,” says Salman bin Isa Al-Khalifa, the executive director of Bahrain’s banking operations.

Until now the Gulf’s bond markets have been anaemic. Debt securities make up 33% of world capital markets but only 3% in the Middle East. The growing popularity of Islamic finance over the past decade has provided a small boost. Issuance of *sukuks*, which comply with *sharia* law prohibitions on interest, grew to $43 billion in 2007, though that is a sliver of the $50 trillion-plus global bond market. But last year global *sukuk* sales more than halved (see chart). Companies hunkered down after the credit crisis, taking out bank loans when they could. And oil-rich governments had no need to borrow.

But debt finance can provide large amounts of liquidity quickly in moments of crisis, says Rohit Chawdhry of Bahrain Islamic Bank. Governments learnt this lesson too late when they suddenly found themselves with rising deficits or, in the case of the United Arab Emirates, with what is believed to be a fall of 75% in foreign-currency reserves. They have been forced to sell large amounts of paper.

Abu Dhabi, Dubai and Qatar, some of the world’s richest sovereigns, have issued billions of dollars-worth of conventional bonds in recent months. Bahrain is expected to offer a $500m *sukuk* shortly, its first in 2009, and hopes to hold regular bond auctions afterwards. Other Gulf countries including Kuwait and ultraconservative Saudi Arabia may follow. At the same time quasi-government institutions are seeking credit ratings so they too can issue debt.

Ronald Grant

The name is Bond. Or Sukuk

These are not isolated acts. Regional governments are co-ordinating efforts to develop secondary bond trading; in the past creditors tended to hold the few bonds that were issued to maturity. The new government issuance will help develop a yield curve, which will make for more efficient pricing and give corporate issuers a benchmark to price against (Bahrain hopes that firms will follow the government lead). Aldar, one of the largest Emirati property developers, has reportedly retained advisers to consider issuing bonds.

Nor should the region be particularly discouraged by the high-profile default of a *sukuk* this month when Investment Dar, the Kuwaiti part-owner of Aston Martin, James Bond’s favourite car, missed a $100m payment. A bona fide default just makes the *sukuk* market look even more like its Western equivalent.

**Why banks sponsor sport**

# Play on

May 28th 2009
From The Economist print edition

**Banks are still packing stadiums despite the crisis**

FOR fans of Newcastle United, a terrible season ended as they had long feared on May 24th, with relegation from the Premier League, the top level of English football. Newcastle's players have proved about as buoyant as their shirt sponsor, Northern Rock. The nationalised mortgage bank is based in the city.

In the world of sport, it is hard to get away from banks. The Premier League is sponsored by Barclays. HSBC is backing the British & Irish Lions' rugby tour to South Africa, which starts this weekend. The success of Lewis Hamilton, Formula One's champion driver, has helped make Santander better known in Britain. On May 27th it said it would rebrand its well-known British operations, Abbey, Alliance & Leicester and Bradford & Bingley, under the Spanish name. It reckons the task has been made easier by its high visibility as McLaren's sponsor.

PA

Rock and a hard place

American banks are just as eager as European ones. In 2008, says William Chipps of *IEG Sponsorship Report*, a newsletter, banks laid out $900m on North American rights, 9% of the total. Andrew Zimbalist, an economist at Smith College, says banks' interest has grown enormously with the "gentrification" of sport. Stadiums are newer, seats are comfier (and pricier) and the crowd is better heeled.

Not surprisingly, global recession and the banking crisis have taken their toll. Mr Chipps expects sponsorship of sport (by all companies, not just banks) to grow by just 1.8% in North America this year, down from 14.8% in 2008 and 11.2% in 2007. Banks and their customers are watching every penny. With many financial institutions propped up by taxpayers' money, so are politicians and the press.

Some deals have ended: RBS (mostly owned by the British government) is quitting Formula One at the end of next season. Some have not gone ahead. Bank of America (BofA) has put off a juicy long-term deal with the New York Yankees and extended its existing contract for a year. Others have been quietly shelved or derided as monuments to corporate excess.

More surprising, given all the fuss, is that plenty of banks are still sponsoring sport. This month Investec, a bank already keen on rugby and cricket, agreed to support the (English) Derby until 2013. The classic horse race had long been seeking a backer. It looks likely that Santander will switch to Formula One's most famous name, Ferrari, in 2010. In Britain the £80m ($124m) of support agreed on in 2007 by Lloyds TSB (now Lloyds Banking Group) for the 2012 Olympic games has raised barely a squeak, despite the copious state support Lloyds has received.

Why do shareholders—and taxpayers—play along? For a start, sponsorship gets you noticed, especially in a new market. Among big banks, BofA has made it a speciality, becoming the "official bank" of several sports and forming partnerships with several teams. A deal with a team, for example, brings in retail custom, through affiliated debit and credit cards and the automated teller machines dotted around a stadium. It opens the door to managing the wealth of a team's owners and players, or to arranging the finance for a new stadium. On top of that come tickets, space to entertain and impress clients, and the marketing value of having the bank's name emblazoned around a stadium.

The bank claims to make $3 of profit for every $1 it spends on sports marketing, a rate of return that may look too good to be true (if it can make 300%, it should do nothing else). The long-term deal with the Yankees, says Ray Bednar, BofA's head of sponsorships, "worked fantastically from a return-on-investment perspective, but the environment was wrong. We walked away from a lot of revenue and

profit."

Sponsorship is also important inside as well as outside the sponsoring company. Stephen Greyser, a professor of marketing at Harvard Business School, notes that UBS, a Swiss bank, used its sponsorship of Alinghi, the sailing team that won the America's Cup in 2007, to enthuse its employees. Sally Hancock, director of group sponsorship at Lloyds, says that backing the Olympics "changes the way we think and act as a business". The bank can bring in British Olympians to meet and help motivate staff. "What people don't see is how we're using the Olympic access for our training and development," she says. That is timely. If ever Lloyds needed Olympians, it is now.

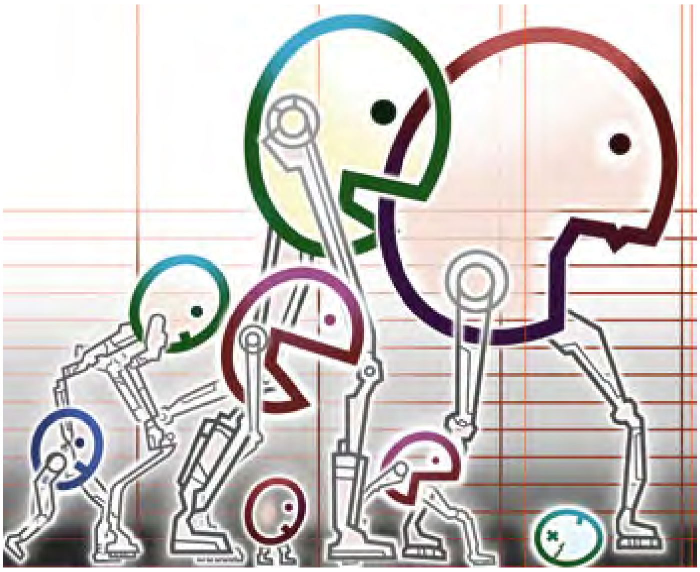
Economics focus

# What's mine is yours

May 28th 2009
From The Economist print edition

**When should firms be required to share their intellectual property with rivals?**

Illustration by Jac Depczyk



ECONOMIC policy is rarely uniform on either side of the Atlantic, but the differences in some cases are exaggerated or soon narrowed. That is true of antitrust policy, where there has been a great deal of convergence. The European Commission's trustbusters tend to take a more cautious view of big global mergers, but the way such tie-ups are assessed is very similar to American practice. In the policing of cartels, the commission has adopted many of the methods and models of its American cousins.

On one antitrust issue, though, the transatlantic gulf has been unusually wide: how to deal with firms with a market share so large as to dwarf their rivals. In high-tech industries, such as computing and telecoms, the power of network effects encourages firms to settle on an industry standard to ensure that gadgets and software are compatible. That gives the owners of the winning standards, such as Microsoft, a great deal of market muscle.

That kind of dominance creates a tension between property rights and antitrust principles. American competition authorities have been loth to compel dominant firms to grant rivals access to their private property, whether physical (as in the case of telecoms networks) or virtual (as with computer code). In their view intellectual-property rights have to be upheld to induce firms to innovate. Patents and copyrights are the rightful prize for new inventions. Trustbusters should be wary of compelling firms to hand over their business secrets in the name of competition.

By contrast, Europe's trustbusters have acted to free up access to telecoms networks in France and Germany. Backed by the courts, they have required Microsoft to make private information about its Windows operating system available to rivals, who can then compete more readily in software development.

Which view is right? In a new paper* John Vickers of Oxford University surveys the economics literature and concludes that a hands-off approach is far from ideal. Mr Vickers, once head of the Office of Fair Trading, Britain's main antitrust outfit, says that like many economists he finds himself "rowing in the mid-Atlantic" when it comes to the treatment of dominant firms. American policy is too cautious about treading on big firms' toes but Europe's trustbusters may intervene too boldly.

Drawing on recent academic work, Mr Vickers makes the case for intervention on three counts. First, he

outlines models that suggest a rival is less likely to develop new products if it cannot share in the profits from the dominant firm's invention. If the leading firm is free to licence its technology on stringent terms, it curbs the profits of rivals who have to stump up. True, it spurs rival firms to innovate since the prospective pay-off is greater. But on balance, the incentive to innovate is greater where access is granted more freely, because upfront profits are more valuable.

A second argument for reining in dominant firms is that the contest to innovate tends to be keenest where there is a neck-and-neck battle to be the dominant firm. If market leaders are forced to license their know-how on easy terms, that reduces the pay-off from research and development (R&D). But it also allows much smaller firms to catch up quickly. Although profits from any new inventions will be lower, they will be chased more aggressively when competitors are on a similar footing.

Trustbusters may have most reason to trespass on property rights if the dominant firm uses them to stifle "follow-on" innovation. An ideal set-up would reward seminal inventions without strangling their related offspring at birth. That means giving the breakthrough inventor a share of profits from related products while leaving enough left over to make rivals' R&D viable. If the dominant outfit is afraid a new add-on will make its own technology redundant, it will not deal with competitors on any terms. So trustbusters may have to step in. Indeed, the case against Microsoft in America was that it tried to force Netscape out of the market for web browsers, fearing its rival's software could be used as a platform to compete against Windows.

## From east to west

The literature surveyed by Mr Vickers suggests that if trustbusters act to keep dominant firms in line, that will not necessarily curb innovation. It may even promote it. Economic thinking in this sphere is not so securely fixed as to provide firm guidance on when to intervene. It does, however, call into question the scepticism that guided America's competition policy in recent years—the idea that trustbusters cannot be certain that their interventions will help, so should back off. That doctrine has been abandoned. Christine Varney, President Obama's chief trustbuster, gave a speech on May 11th in which she repudiated the "overly lenient" course favoured by the previous administration.

Ms Varney's remarks suggest that the transatlantic flow of ideas on antitrust policy may now be moving from east to west. Yet Mr Vickers frets that European courts may not exert enough discipline on the commission's future actions in this area. The court ruling that upheld the commission's action against Microsoft, in September 2007, suggests that the hurdle for such an intervention is less exceptional than had previously been thought. The "elastic" reading of case law left it unclear in what circumstances a dominant firm must share its intellectual property.

For Mr Vickers the one clear lesson is that intellectual-property rights should not be set too broadly. A precedent for the European case against Microsoft was a 1990s judgment against television companies, which forced them to hand over broadcast schedules to publishers of TV guides. The broadcasters fought the case tooth and nail to preserve their publication monopolies. Yet many may now wonder how such information could ever have been thought of as intellectual property.

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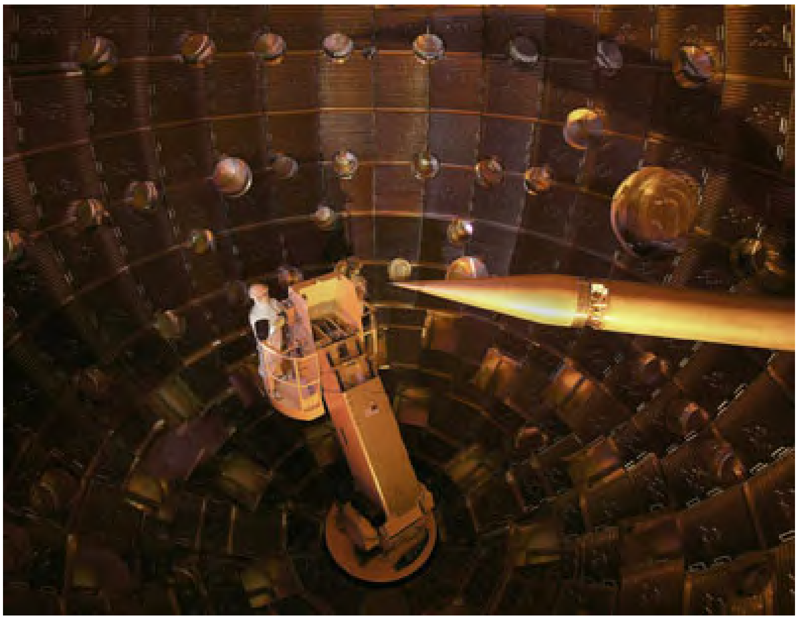
"Competition Policy and Property Rights" (May 2009). www.economics.ox.ac.uk/research/wp/pdf/paper436.pdf

**The National Ignition Facility**

# On target, finally

May 28th 2009
From The Economist print edition

**A machine for testing nuclear weapons opens for business**



WHAT do you get when you focus 192 lasers onto a pellet the size of a match head and press the “fire” button? The answer, hope physicists at the National Ignition Facility (NIF) in Livermore, California, is: the most powerful machine on the planet. The NIF, which is scheduled to go into operation on May 29th, is designed to create conditions like those found in stars—and also in the explosions of hydrogen bombs. To do that requires, for the brief instants when it is operating at full tilt (a total of three thousandths of a second a year), that it has a power of 500 trillion watts, about 3,000 times the average electricity consumption of the whole of planet Earth.

The pellets at which this energy is directed are made of frozen hydrogen. The aim is to make those pellets undergo nuclear fusion—the process that causes stars to shine and hydrogen bombs to explode. Although the justification for building the NIF has changed over the years (originally there was talk of it being a prototype for fusion-based power stations), it is the resemblance to bombs which has saved the project from the budgetary chop. For the NIF provides America with a way to carry out nuclear-weapons tests without actually testing any weapons.

Had the NIF been a purely scientific project, it would almost certainly have been cancelled. It has cost $4 billion so far, almost four times the original estimate, and is running more than five years behind schedule. Construction started in May 1997 but the initial design proved impractical and was sent back to the drawing board. In 2000 the Department of Energy, which is responsible for the Lawrence Livermore National Laboratory, the NIF’s host, altered the design and revised its budget and deadlines. And in July 2005 Congress actually voted to suspend construction of the machine—relenting only when extra money was found to compensate for cost overruns that had threatened to penalise the work of two other energy-department laboratories that drew their cash from the same pot.

## Testing, testing

What ultimately saved the NIF from cancellation was that its backers persuaded politicians it was vital to the “stockpile stewardship” programme for America’s nuclear bombs. Although America has not ratified the Comprehensive Test-Ban Treaty, it suspended the testing of its nuclear weapons in 1992. Instead of

weapons development, nuclear-weapons scientists are now engaged in a programme intended to ensure that the country's existing warheads will continue to function predictably as they age. This work uses "subcritical" tests that do not involve full nuclear detonations, and computer simulations of how a weapon would explode.

Such simulations are all well and good, but they must, from time to time, be tested against the real world. That is where the NIF comes in. It will, if it works, create real nuclear explosions, not subcritical phuts. These explosions will be too small to count as nuclear tests within the meaning of the treaty (which America tries to abide by, even though it has not signed). They will, however, be big enough to yield information useful to nuclear-weapons scientists.

Each laser pulse will begin as a weak infra-red beam. This is split into 48 daughter beams that are then fed into preamplifiers which increase their power 20 billion times. Each of the daughters is split further, into four, and passed repeatedly through the main amplifiers. These increase the beams' power 15,000 times and push their wavelengths into the ultraviolet.

The pellet itself contains a sphere of deuterium (a heavy form of hydrogen, with nuclei consisting of a proton and a neutron) and tritium (even heavier hydrogen, with a proton and two neutrons) that is chilled to just a degree or so above absolute zero. The beams should compress the sphere so rapidly that it implodes, squeezing deuterium and tritium nuclei together until they overcome their mutual repulsion and fuse to form helium (two protons and two neutrons) together with a surplus neutron and a lot of heat. If enough heat is generated it will sustain the process of fusion without laser input, until most of the nuclear fuel has been used up.

Physicists hope that in the coming year or so the NIF will become the first machine to achieve a nuclear-fusion reaction that produces more energy than it takes to ignite, albeit for only a fraction of a second. Sceptics reckon that the machine may not be capable of such a feat. Creating a sustained nuclear-fusion reaction that could generate power is the goal of another mammoth experiment, the International Experimental Thermonuclear Reactor, which is being built in Cadarache, France. Plenty of people are sceptical about the likely success of that project, too. Like the NIF, it appears to be slipping behind schedule. Full experiments to test nuclear fusion as a power source seem likely to be delayed until 2025.

If the NIF does work, the bomb-scientists will be ecstatic. Astrophysicists will be pretty pleased, too. Although they will get only about 200 of the annual budget of between 700 and 1,000 runs, they will be able to use their time on the machine to simulate the interiors of giant planets, stars and exploding supernovae, by varying the compositions of the pellets to match what they think those things are made of. Bombs or no bombs, astronomy will start to move from being an observational to an experimental science. At a mere $140m a year, then, the NIF is a snip.

Economist.com SCIENCE & TECHNOLOGY

The origin of swine flu

# Putting the pieces together

May 28th 2009 | NEW YORK
From The Economist print edition

**A better understanding of how the new strain of influenza arose**

EPA

**What? Us?**

YOU are now officially permitted to blame the pigs. When a strain of influenza with pandemic potential struck in April, it was generally referred to as “swine flu” because it seemed similar to an existing group of strains, known as A/H1N1, which are commonly found in pigs. But when it became clear that the new bug was being spread by people, not porkers, the pig-breeding industry complained that it was being unfairly maligned. It also became apparent that the new virus contains bits and pieces derived from avian and human strains of influenza, as well as porcine ones, further muddying its origins.

A new study, however, suggests pigs really were to blame. Several dozen researchers, led by Rebecca Garten of America’s Centres for Disease Control and Prevention (CDC), sequenced full or partial genomes of 76 samples of the new virus, which has afflicted almost 13,000 people around the world so far. In a paper published in *Science*, they confirm that the closest genetic relatives of the new virus are swine-flu strains from both North America and Eurasia. The virus is made of eight gene segments of known provenance but which have not previously been seen in this combination. The genetic material in them is indeed a hotchpotch derived from avian, human and swine sources, but all eight segments come most recently from pigs.

On the positive side, the researchers discovered that the antigens (proteins that provoke an immune response) found in different samples have remained similar to each other. That, according to Derek Smith of Cambridge University, one of the paper’s authors, may make it easier to design a vaccine against the new virus. The World Health Organisation and a number of European governments are now talking to manufacturers about expediting the development of such a vaccine and, on May 22nd, American officials announced a $1 billion scheme with the same goal.

The worrying news is that the study found the genetic material in the new influenza is significantly different from that in its known close relatives. This, they conclude, means the bug was circulating and evolving undetected in swine for quite some time before the first people were infected. In other words, the early-warning systems did not work.

Another cause for concern is that Canadian officials recently confirmed that the new strain has hopped from humans back into pigs in Alberta. Because swine are natural mixing vessels for influenza strains from different species (hence the hotchpotch found by Dr Garten and her colleagues), the fear is that a deadlier form could emerge and jump back into humans.

This new study does not answer the big questions of how, exactly, the virus crossed over to humans and

why it kills some people and not others—in particular, why it hits the young (and thus, presumably, healthy) harder than the elderly. A different study by the CDC has found that nearly two-thirds of swine-flu infections in America have been in people aged between five and 24, whereas only 1% of cases affected those over 65. This is the reverse of the pattern seen in seasonal flu, which kills thousands of old people every winter. One possible explanation, according to Anne Schuchat of the CDC, is that “older adults might have been in contact a long time ago with a virus similar to the one we see now.” That, she surmises, might give them an immunity to this new menace that young people lack.

**The behavioural effects of video games**

# Good game?

May 28th 2009
From The Economist print edition

**Playing video games can make you a better person**

VIDEO games get a bad press. Many are unquestionably violent and, as has been the way with new media from novels to comic books to television, they have been accused of corrupting the moral fabric of youth. Nor are such accusations without merit. There is a body of research suggesting that violent games can lead to aggressive thoughts, if not to violence itself. But not all games are shoot-'em-ups, and what is less examined is whether those that reward more constructive behaviour also have lingering impacts. That, however, is starting to change. Two studies showing that video games have a bright side as well as a dark one have been carried out recently.

One, to be published in June by the *Journal of Experimental Social Psychology*, was conducted by Douglas Gentile, of Iowa State University's media research laboratory. He and his colleagues tested the effects of playing so-called "pro-social" games on children and young adults in three countries.

A group of 161 American students played one of six games for 20 minutes. Some were given "Ty2" or "Crash Twinsanity", both of which involve cartoonish fighting and destruction. Others were assigned "Chibi-Robo!", which involves helping characters in the game by doing their chores, or "Super Mario Sunshine", in which players clean up pollution and graffiti. A third group, acting as a control, played "Pure Pinball" or "Super Monkey Ball Deluxe", both of which involve guiding a ball through mazes.

Their games over, the participants were asked to choose 11 of 30 easy, medium or hard shape-based puzzles for a partner to complete, and told that their partner would receive a $10 gift voucher if he could complete ten of them. Those who had been playing pro-social games were significantly more likely to help their partner by selecting easy puzzles. The opposite was true for those assigned violent games.

The other parts of Dr Gentile's study looked at established behaviour. In one, a group of 680 Singaporeans aged 12-14 were asked to list their three favourite games and state the number of hours they played. They were then given questionnaires, the answers to which suggested that those who spent the longest playing games which involved helping others were most likely to help, share, co-operate and empathise with others. They also had lower scores in tests for hostile thoughts and the acceptance of violence as normal. In the second, Japanese aged 10-17 were asked how much time they spent playing games in which the main character helps others. When questioned three to four months later, those who played these types of games the most were also rated as more helpful to those around them in real life.

## Screened for virtue

These two, later, parts of Dr Gentile's study might, of course, just be proving that nice people prefer pro-social games. But a second controlled experiment, by Tobias Greitemeyer of the University of Sussex, in England, and Silvia Osswald of Ludwig-Maximilian University, in Munich, confirms the gist of Dr Gentile's conclusions. In this piece of research (to be published later this year, also in the *Journal of Experimental Social Psychology*), Dr Greitemeyer and Dr Osswald asked 46 German students to play one of two classic games. In the pro-social one, "Lemmings", the aim is to protect rodents from various dangers. By contrast "Tetris" acted as a neutral control. In this game players rotate falling shapes so that they slot neatly together instead of saving self-destructive furry animals.

Playtime over, the students were asked to say what happens next in three incomplete stories involving a driver and a cyclist who narrowly miss colliding; two friends, one of whom is unapologetic despite being repeatedly late; and a diner speaking to a restaurant manager after waiting for an hour to be served and then having food spilt on him. Those who had played "Lemmings" suggested endings in which the characters in the stories exhibited significantly fewer aggressive thoughts, responses and actions than the ones suggested by the "Tetris" players.

The upshot of both studies is that video games are like any other medium. Feed the user with aggressive thoughts and you risk making him aggressive. Feed him with the milk of human kindness and the opposite will probably happen. No great surprise, perhaps. But a salutary reminder both that the older generation should not rush to judgment on youthful habits it does not understand, and that the medium is not always the message.

**Tool use by non-tool-using animals**

# Sticks and stones

May 28th 2009
From The Economist print edition

**Rooks, which do not use tools in the wild, can make and use them in the lab**

Nature Picture Library

**Pass the Black & Decker**

FINDING animals that engage in the human activity of tool use has become a bit of a cottage industry. Chimpanzees, orang-utans, monkeys, various birds and even some insects can manage it. Finding a species that can use tools but doesn't is, however, a surprise. But that is what Christopher Bird and Nathan Emery of Cambridge University have done. As they report in the *Proceedings of the National Academy of Sciences*, they have discovered that rooks, which have never been seen to use tools in the wild, can learn to use them, and even make them, in the laboratory.

The basic task Dr Bird and Dr Emery set their rooks was to recover a tasty morsel called a waxworm. This was placed on an out-of-reach platform that could be brought within reach by dropping a stone, or pushing a stick, down a tube. In the first experiment, the rooks were presented with the apparatus (which they had never seen before) and left to get on with it. Not all of them worked out what to do, but four that did were selected and tested with more and more sophisticated versions of the task.

First, they were given stones of different sizes. When all these stones would fit down the tube, every bird preferred the biggest stone. If a narrower tube was used, though, the birds seemed to realise the significance of the change and picked a smaller stone, usually without trial and error. They were even able to do this when the stones and the apparatus were out of sight of each other.

Next, the experimenters substituted sticks for the stones. The birds worked this one out, too. Given heavy sticks, they just dropped them into the tubes as they did with stones. Given lighter ones, they realised they had to hold on to the stick and push down on the platform. When presented with a stick and a stone, they also picked the right tool for the job. Given a long stick and a stone too big to fit down the tube, they chose the stick without hesitation. Given a stick too short to be useful, and a stone of the right size, they chose the stone. They were even able to use a stone of the wrong size to release one of the right size, which they then used to get the waxworm, and, more remarkably still, to prune twigs off a stick to make it fit the tube.

On top of all this they were able, in a different sort of test, to bend a piece of wire into a hook to retrieve a bucket containing a waxworm. These last two tasks—stick modification and hookmaking—are equivalent to the sort of tool construction that chimpanzees engage in when they go "fishing" for termites in their nests. And, although New Caledonian crows, which also make tools in the wild, can manage the hookmaking trick, wild rooks are tool-using virgins.

The upshot is that toolmaking, at least in crows, does not look like a specifically evolved ability but rather an extension of general intelligence. Perhaps wild rooks are not presented with a need to use tools, and so don't bother. What this implies for the evolution of human toolmaking is unclear. But it puts a new spin on the phrase "bird-brained".

Economist.com BOOKS & ARTS

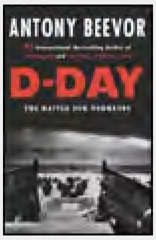
D-Day and the Normandy landings

# The full version

May 28th 2009
From The Economist print edition

**France liberated, the full version**

D-Day: The Battle for Normandy
By Antony Beevor




*Viking Adult; 592 pages; £25. To be published in America by Viking in October*

Buy it at
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Getty Images

MOST of the young soldiers pictured above are now dead. The battles they fought in Normandy, France, are fading into history and acquiring the patina of Verdun, Gettysburg and Waterloo. This new historical distance gives Antony Beevor, who made his name with his 1998 bestseller, “Stalingrad”, the freedom to explore without inhibition the most controversial questions posed by the campaign that opened with the storming of the French beaches on June 6th 1944. It is a freedom he exploits to the full in his new book, “D-Day: The Battle for Normandy”.

The first issue Mr Beevor tackles is the courage of the German troops. Many wondered what the Germans would think when they caught sight of the allied armada, the largest fleet that had ever put to sea. Nearly 5,000 landing ships and assault craft were escorted by six battleships, four monitors, 23 cruisers, 104 destroyers and 152 escort vessels, while 277 minesweepers cleared channels ahead of them.

The Germans did not flinch. Their doggedness earned them the “bitter admiration” of the allied forces as

they fought their bloody way through Normandy to liberate Paris. Major-General Raymond Barton, the commander of the American fourth division, urged his unit commanders to tell their men: “We have got to fight for our country just as hard as the Germans are fighting for theirs.” Only the guts of their soldiers, Barton said, kept the Germans in the war. “We outnumber them ten to one in infantry, 50 to one in artillery and an infinite number in the air.”

Nonetheless, Mr Beevor believes that military analysts like Sir Basil Liddell Hart are unduly harsh when they criticise a “reluctance to make sacrifices” on the allied side. The “essentially civilian soldiers” of a democracy, he argues, could not be expected to show the same level of commitment as indoctrinated German soldiers convinced that they were fighting to defend their country from annihilation.

Mr Beevor moves on to even more delicate ground when he explores the disregard of the allies for the property and lives of French civilians. In the Normandy campaign the Americans and British sought to minimise their casualties by bombing places to smithereens before their soldiers went in. Asked how it felt under the bombardment, one elderly survivor in the town of Caen replied: “Imagine a rat sewn up inside a football during an international match.” As a consequence of this tactic, 70,000 French civilians were killed by allied action in the war, more than the number of British killed by German bombing.

The record of the French resistance is also examined critically. George Patton, the bellicose American general nicknamed “Old Blood and Guts” by his adoring soldiers, described its performance as “better than expected and less than advertised”. But Mr Beevor shows that the contribution of the resistance was considerable, especially in Brittany where its members loaded ammunition, cleared snipers, secured bridges, provided intelligence and harassed Germans at every turn.

By contrast, French mobs in liberated towns behaved appallingly badly. In the *épuration sauvage*, or unofficial purges, at least 14,000 alleged collaborators were killed. In Brittany, one-third of them were women. French people as well as allied troops were sickened by the treatment meted out to those accused of *collaboration horizontale*. After undergoing the humiliation of having their heads shaved they were paraded through the streets, occasionally to the sound of drums, as if France was re-enacting the Reign of Terror in the French revolution. Some were daubed with tar, others stripped half naked, many painted with swastikas.

Quite simply, Mr Beevor concludes, these young women were the easiest scapegoats, particularly for men who wished to hide their own lack of resistance credentials. The explosive growth in numbers in the French resistance was, of course, incredible. Village boys who had flirted and danced their way through the German occupation suddenly appeared with a brassard and a submachinegun.

Against this backdrop, the triumphalism of some of the top brass on the allied side during the campaign now sounds callous. Take, for instance, the boast of General Sir Bernard (later Lord) Montgomery: “The victory has been definite, complete and decisive. ‘The Lord mighty in battle’ has given us the victory.”

D-Day: The Battle for Normandy.
By Antony Beevor.
*Viking Adult; 592 pages; £25. To be published in America by Viking in October*

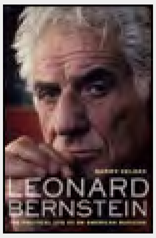
**Leonard Bernstein**

# A political life

May 28th 2009
From The Economist print edition

IN AN article he wrote for the *New York Times* in October 1988 Leonard Bernstein, then America's most famous conductor-composer, unleashed a stinging attack on his countrymen. He castigated American voters and their leaders for what he saw as a wholesale betrayal of the values on which the union was founded. At a time when "liberal" had become a dirty word, he rounded on his fellow citizens for allowing themselves to be duped by cold-war mythology into sacrificing social and culture budgets for dubious military gain. Bernstein died two years later, his lifelong wish to complete "That One Important Piece", as he described it in his final letter to his business manager, left as unfulfilled as his longing to see liberal democracy flourish in America.

Leonard Bernstein: The Political Life of an American Musician
By Barry Seldes




*University of California Press; 288 pages; $24.95 and £14.95*



Magnum

**Moves of a moral maestro**

Why did the popular, powerful and prodigiously gifted Bernstein never compose that masterpiece? This is the central question Barry Seldes asks in his new political biography. The usual answer turns on the suggestion that Bernstein's talents were overstretched by his heavy conducting, recording and publicity schedules. Critics also like to carp, pointing out that, although he was a brilliant musician, Bernstein somehow lacked the depth of thought and vision necessary to produce a genuine masterpiece.

Mr Seldes's answer is different. Bernstein, he says, never wrote "That One Important Piece" because the only audience for which he could have written it—an American citizenry united by progressive liberalism—failed to materialise.

A close friend of President John Kennedy and his wife, Bernstein made no secret of his general affiliation with the progressive strain of American political life. Indeed he was mildly notorious for his "radical chic", as Tom Wolfe put it, and for lending his popularity to whichever "nice liberal cause" happened to come along. Unfortunately for Bernstein, one of the more prominent causes for which he organised a fund-raising reception was that of the Black Panthers. Accused of being a revolutionary, or at best a naif, Bernstein never recovered from the damage this did to his reputation.

Mr Seldes argues that this was unfair. Not only were Bernstein's politics entirely sincere, they were wholly of a piece with his artistic aims. Nurtured in the atmosphere of committed liberalism generated by the New Deal, and by such musicians as Aaron Copland, for whom artistic progress and the formation of an authentically American artistic identity were inseparable from ideas of social change, Bernstein developed quickly into an able spokesman for American cosmopolitan progressivism's short-lived ascendancy. However, he was continually followed by the FBI and eventually blacklisted by the State Department. His directorship of the New York Philharmonic Orchestra and his lucrative recording contract with Columbia Records survived only because he signed a humiliating affidavit in which he renounced the full range of his extensive civil-rights and left-wing commitments.

Mr Seldes's book is a masterpiece of concision, romping through background accounts of the machinations of the House Committee on Un-American Activities and the collapse of post-war efforts to revive the liberal political philosophies of the New Deal generation. He turns with equally efficient grace to interpretations of Bernstein's more enigmatic compositions, such as his theatrical setting of the "Mass" and his disillusioned follow-up to "Trouble in Tahiti" with an opera, "A Quiet Place". The book's greatest value, however, lies not simply in shedding new and more nuanced light on the story of "Our Lenny", but in its consistent demonstration—in accordance with Bernstein's own ideas—that any attempt to separate the musical sphere from the moral and political comes at an unconscionably high price.

Leonard Bernstein: The Political Life of an American Musician.
By Barry Seldes.
*University of California Press; 288 pages; $24.95 and £14.95*

Economist.com BOOKS & ARTS

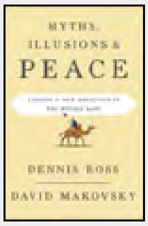
**Middle East diplomacy**

# Myths, illusions and peace

May 28th 2009
From The Economist print edition

WHEN Barack Obama speaks to the Muslim world in Cairo on June 4th, his audience will want to know, above all, what he proposes to do about Palestine. Bill Clinton tried intense mediation, but it led to the explosion of the second Palestinian *intifada* in 2000. George Bush ignored the conflict and then called on Palestinians to dump their leader, Yasser Arafat, only to see a Hamas electoral victory in 2006 and some appalling violence in Gaza.

Myths, Illusions, & Peace: Finding a New Direction for America in the Middle East
By Dennis Ross and David Makovsky




*Viking; 366 pages; $27.95*



Mr Obama could do worse, before he goes, than read the thoughts of Dennis Ross, a veteran American mediator with considerable experience of the Israeli-Arab conflict, and David Makovsky, a colleague from a think-tank in Washington, DC. In their new book, the authors caution American leaders against believing they can either let the problem fix itself or impose peace. Instead they advocate diplomatic engagement “without illusions”: diplomacy may not achieve peace, but it might prevent the conflict from worsening.

So much blood has been shed in the years since the 1993 Oslo accords that, the authors insist, “the most formidable obstacle is the disbelief that exists on both sides”. For Israelis, territorial concessions have provoked more terrorism; for Palestinians, coming to terms with Zionism has led to more stifling occupation and the expansion of Jewish settlements. Grand declarations will count for nothing without tangible signs of change, big and small, on the ground. In short, America “cannot afford to raise expectations again”.

The authors seek to debunk several misconceptions, particularly the idea that the Israeli-Palestinian conflict is the central problem of the Middle East, and is damaging America’s relations with the rest of the region. This notion of “linkage”, they say, is the “mother of all myths”. It allows Arab leaders to blame everyone but themselves. In practice, they usually pay only lip service to the Palestinian cause, and inter-Arab rivalry trumps other considerations. Such arguments have some truth, but are overdone. The authors themselves recognise that the conflict is stoking Islamic radicalism and anti-Americanism—that is why they want America to pursue peace.

The most interesting section of the book deals with the dilemma over whom America should talk to. The authors oppose dialogue with armed militant groups such as Hamas and Hizbullah, despite their strength, electoral success and proven ability to act as spoilers. And yet the authors think it is right for America to talk to Iran, a major sponsor of Hamas and Hizbullah, without preconditions. (Mr Ross is now Hillary Clinton’s adviser on Iran.)

Why the difference? Because, the authors say, Iran is a state whose calculations can be influenced by America. Hamas and Hizbullah, by contrast, are violent ideological groups willing to provoke wars; talking to them only undermines moderates. That said, they argue, talks with Iran should not be open-ended and must be accompanied by economic and political pressure, perhaps applied by Europe, Russia and Saudi Arabia. America could extend its nuclear umbrella to Iran’s neighbours.

This combination, the authors say, is more likely to convince Iran to give up the quest for nuclear weapons. And if diplomacy fails, then the effort at talks could help “set the stage for the use of force if agreement proves not to be possible”.

Myths, Illusions, & Peace: Finding a New Direction for America in the Middle East.
By Dennis Ross and David Makovsky.
*Viking; 366 pages; $27.95*

Alice Munro's short stories

# A well-deserved win

May 28th 2009
From The Economist print edition

## A win for a neglected genre

Eyevine

**Word perfect**

IS THE short story enjoying a renaissance? The genre of choice for writers as highly regarded as Jorge Luis Borges and John Cheever, short fiction in the past decade has got shorter and shorter shrift from publishers who believe it does not sell. That may be changing.

Just over a year ago, Jhumpa Lahiri's second collection, "Unaccustomed Earth", leapt straight to the top of the *New York Times* bestseller list in its first week of publication. "Occasionally a comet lands and flattens the forest, sending the usual critters running," one of the paper's bloggers commented. Then the London *Sunday Times*, usually a forum for bloody foreign reporting or high fashion, began commissioning short fiction of its own from such authors as Lionel Shriver and Ben Okri.

On May 27th the short story raised its longest applause yet when it was announced that Alice Munro, a 77-year-old Canadian, had won the Man Booker international prize, the first time a short-story writer has carried the day.

In search of what they call "an achievement in fiction", the three judges had spent much of the past two years reading 300 books by more than 70 living authors. Ms Munro comes from southern Ontario, an area of considerable psychic murkiness and oddity. Her stories dwell on her own people and their peculiarities: their repressed emotions, respectable fronts, hidden sexual excesses, outbreaks of violence, lurid crimes and long-held grudges.

Ms Munro, who has long been honoured in her native country, does not enjoy the same international renown as some of her competitors for the prize, in part because she writes short stories rather than novels as thick as doorsteps.

The final judging saw the panel arguing over the merits of James Kelman's gritty social realism ("the Maxim Gorky of our day", one judge said), Joyce Carol Oates's appeal to the head and Mario Vargas Llosa's call to the heart. Jane Smiley, who chaired the judges, said: "To read Alice Munro is to learn something every time that you never thought of before."

Or as Ms Munro's more famous fellow Canadian, Margaret Atwood, once remarked: "You call this writing? Alice Munro! Now *that's* writing."

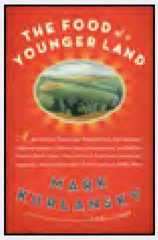
**Mark Kurlansky**

# America eats, belatedly

May 28th 2009
From The Economist print edition

MARK KURLANSKY has written on a wide range of subjects, but is best known for his books on food—notably “Cod: A Biography of the Fish that Changed the World” and “Salt: A World History”. Mr Kurlansky returns to the subject with his latest work, “The Food of a Younger Land”, an anthology of food writing from 1930s America.

The Food of a Younger Land: A Portrait of American Food from the Lost WPA Files
By Mark Kurlansky




*Riverhead Books; 416 pages; $27.95*

Buy it at
Amazon.com
Amazon.co.uk

This apparently arcane material is topical for two reasons. First, Mr Kurlansky draws upon an archive of food writing compiled by the Federal Writers’ Project (FWP), set up to create jobs in 1935 as part of the Works Progress Administration. Second, this snapshot of America’s food culture and eating habits predates the homogenising influence of Wal-Mart, McDonald’s and so on. The book catalogues the diversity of cuisines within America and an abundance of local food traditions. These have not entirely died out, but at a time when comparisons with the Depression are being drawn and interest in “local food” is on the rise, in America and elsewhere, Mr Kurlansky’s book is especially welcome.

Corbis

**Who's for lunch?**

The material in “The Food of a Younger Land” was originally compiled for publication in a book called “America Eats” after the FWP’s directors decided to put together a book on food to make use of the expertise of its writers around the country. Even at that time there was a sense that food culture was being lost: frozen food was appearing, as were industrial food products such as Jell-O and ready-made cake mixes. So the editors set out to “preserve not only traditional dishes but also traditional attitudes and customs” and decreed that “emphasis should be divided between food and people.” The resulting material contained many references to recipes from the civil-war era, and some items look back as far as the colonial period. But apart from a recipe for “Depression Cake” (without flour or eggs), there are few direct references to the privations of the time.

The attack on Pearl Harbour, and America’s subsequent entry into the second world war, meant that “America Eats” was never completed. Now, however, Mr Kurlansky has dusted off the files from the FWP archive and chosen the best morsels from a huge amount of raw material. They range from an essay on maple-syrup production in Vermont to squirrel recipes from Arkansas, a poem about Nebraskans’ enthusiasm for frankfurter sausages and a description of how Sioux Indians prepared buffalo meat. As well as providing an introduction, Mr Kurlansky adds his own commentary and sprinkles in the occasional modern reference point: alongside the 1940 Christmas dinner menu from the Brown Hotel in Louisville, Kentucky, for example, the 2007 menu from the same hotel is provided for comparison. (The modern menu includes antipasti and sushi; the 1940 menu mentions neither.)

The numerous recipes are not merely impersonal lists of ingredients and instructions, but are spiced with tips and personal anecdotes. There are arguments over the best way to prepare clam chowder and a mint julep, a list of food superstitions from Colorado (“Do not burn bread crust in the kitchen fire, or bad luck will come to that household”) and a handy guide to New York soda-luncheonette jargon. Some contributions are from FWP writers who went on to successful literary careers, including Eudora Welty, Nelson Algren and Zora Neale Hurston.

Mr Kurlansky notes that at the time “America Eats” was published, “America had rivers on both coasts teeming with salmon” and “squirrels still leapt from conifer to hardwood in the uncut forests of

Appalachia." It is, he says, "terrifying to see how much we have lost in only 70 years." A great deal has changed since this book was compiled. But the account of the popularity of the impersonal, high-speed Automat restaurants of New York (the precursors of later fast-food chains) and a piece ridiculing the "dietists" and "health-food cults" of Los Angeles serve as a reminder that some things have not.

The Food of a Younger Land: A Portrait of American Food from the Lost WPA Files.
By Mark Kurlansky.
*Riverhead Books; 416 pages; $27.95*

**The Hergé museum**

# Totally Tintin

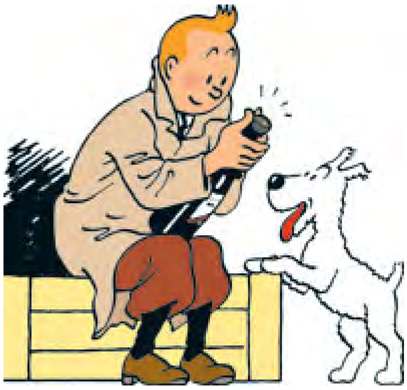
May 28th 2009 | LOUVAIN-LA-NEUVE
From The Economist print edition

**Celebrating one man and his dog**

A SPECTACULAR new museum dedicated to Hergé, the pen name of Georges Remi, who created the comic-book hero Tintin, opens in the Belgian town of Louvain-la-Neuve on June 2nd. The museum, a fine addition to a somewhat drab skyline, is best seen at nightfall or under grey skies, says its architect, Christian de Portzamparc. In murky conditions, the building's structure of angled white planes glows from within, offering glimpses through huge windows of an "imagined landscape" inside.

The museum, newly built at a cost of €15m ($21m), runs around a central atrium formed of curving walls in bold colours, pierced by high metal walkways. An internal lift shaft at the core of the atrium is painted with a chequerboard pattern, evoking the moon rocket in one of Tintin's bestselling adventures. The structure stands on stilts in a park and visitors enter across a long wooden footbridge. It feels like boarding a ship only provisionally moored at Louvain-la-Neuve, a symphony in red brick mediocrity.

Hergé-Moulinsart 2008



**Champagne opening**

Within is a landscape of the imagination, brightly lit and coloured, as outside a steady drizzle falls against the windows from leaden skies. If that sounds like a memory of childhood reading indoors, it is no accident. Since Tintin's first appearance in a Belgian Catholic newspaper 80 years ago, generations have roamed the world vicariously through his comic-book adventures as a trouble-prone (if unusually clean-living) foreign reporter.

In much of Europe, especially in Belgium and France, the stories have gained a devoted following, generating books, academic papers and conferences at which grown men (and it is usually men) debate arcana like the real-world location of Tintin's Brussels home, or the ancestry of Captain Haddock, his best friend and drunken, comic foil. For less obsessive fans, the books are still an important memory. Some 200m albums have been sold in all, giving children their first taste of the exotic as Tintin fights bullies and solves mysteries from the jungles of Latin America to the mountains of Tibet: a sort of cartoon *National Geographic*, with the added appeal of car crashes and fist-fights.

Both groups of fans will find much to please them in the new museum. The brainchild of Hergé's second wife, Fanny Rodwell, who set up the Hergé Foundation in 1987, the museum shows off a rotating collection of original artwork and source materials, laying bare the hard work that Hergé put into his comics, with each speeding car, cityscape or policeman's uniform inspired by archived photographs and research trips in the field. Back in his Brussels studios, Hergé would spend long hours posing as each character while assistants sketched him as a reference guide for the final drawings.

Mr de Portzamparc—a past winner of the Pritzker prize, one of architecture's highest awards—confesses that as an adult he rarely thought about Tintin. But the museum commission awoke memories of sketching Captain Haddock when he was a small boy and of doodling the ocean-going ships that fill the Tintin albums. "It was very easy to open the door and plunge back in," he says.

Yet the museum has another ambition: to cement the claim that Hergé, who died in 1983, was an important artist in his own right, whose talents as a graphic designer, painter and typographer were "somewhat eclipsed by the runaway success of 'The Adventures of Tintin'," to quote one oddly grudging sign on display. The reverential tone of such captions, allied to a general lack of larkishness, make clear this is a serious Hergé museum, not merely a Tintin exhibition. It seems fair to predict that many child visitors will be left decidedly fidgety.

At times, the museum seems to be straining to make its argument. One display highlights Hergé's love of modern art and his friendships in that world (his private collection included works by Andy Warhol, Roy Lichtenstein and Alexander Calder). A sign high on a wall quotes Balthus, a Polish-French modern artist, recalling a happy evening with a sculptor friend, Alberto Giacometti, marvelling at the quality and depth of Hergé's work. Yet the work that the two artists were admiring was a stack of Tintin albums. Quite right too: the Tintin books are by far Hergé's finest achievement, admired by children and famous artists alike. You would think that would be enough.

# Roh Moo-hyun

May 28th 2009
From The Economist print edition

**Roh Moo-hyun, former president of South Korea, died on May 23rd, aged 62**

Getty Images

THE tiny village of Bongha, in south-eastern Korea, is surrounded by rice-paddies and steep woods. After 2008, however, its biggest attraction was Roh Moo-hyun, the former president. It is not every day a son of Bongha peasants ends up in the Blue House in Seoul. As Mr Roh in retirement rode his bicycle round the streets, crowds of tourists would run after him. As he stood smoking familiarly at his garden gate, visitors would clamour for a photograph. People who had never much cared for him as president—too quick to take and cause offence, too keen to raise a convivial glass with North Korea's weird and inscrutable Kim Jong Il—signed on to the website *Roh Sa Mo* ("We Love Roh"), and joined a nationwide fan club.

Mr Roh was an anti-corruption president. In South Korea, that is saying something. The two sons of Kim Dae-jung, the country's most famous modern leader, were imprisoned for graft. Chun Doo-hwan and Roh Tae-woo, both former presidents, went to jail for soliciting hundreds of millions of dollars from the country's biggest business groups. Mr Roh, a son of the soil who had taught himself well enough to get through South Korea's ferocious bar exams, was thought to be different. When he came into office he was candid, moral and refreshing. And when he left, going back to unassuming Bongha, he enhanced his reputation as a man of the people who, though he governed in turmoil and controversy, was at least clean.

He campaigned for virtuous causes all his life, beginning in 1981 with his defence of students arrested and tortured by the Chun regime for possessing banned literature. When he saw "their horrified eyes and their missing toenails", he said later, his comfortable lawyer's life was over. In the mid-1980s he abandoned law for politics, fiercely denouncing graft during televised hearings in the National Assembly. He did not always win popularity, or re-election. But he caught the attention of Kim Dae-jung, organised Mr Kim's successful run for president in 1997 and surprised perhaps even himself by squeaking into the presidency five years later.

His term was tumultuous. Businessmen hated him, remembering his support for striking workers in the "June Struggle" against Chun in the late 1980s, and seeing him as a leftist maverick intent on redistributing wealth from the rich to the poor through higher taxes. Established bureaucrats and

politicians despised the youthful, callow fellow-protesters he brought in with him. Several cherished proposals, including one to institute more checks on the president, went nowhere. At one point Mr Roh was impeached for a minor breach of election rules. But he was not convicted.

The Americans were gravely disturbed to see him improving links with Pyongyang, striding keen as mustard down the fluorescent pink carpet towards the potbellied little tyrant in his zipped-up uniform. Korean troops for Iraq, and a free-trade accord with the United States in 2007, did little to soothe suspicions that he was anti-American. When Mr Roh and George Bush met in Washington, their body language loudly betrayed how mutually ill at ease they were.

## The shoemaker's bribes

Yet Mr Roh was also ill at ease with himself. He had plastic surgery round his eyes, complaining that his eyelashes were poking his eyeballs. Koreans assumed he wanted to improve his looks. He never managed diplomatic small-talk, tended to say the wrong thing, and packed his own instant noodles for state trips abroad. He radiated scorn for those who, unlike himself, had been to university. "Stone bean", as his family called him, the tough, poor youngest son, had risen past all of them without it. While they had been at Seoul National University, or Oxford, or Harvard, he had been pouring cement and mending nets. Yet he admitted early in his term that he felt "incompetent". The burden of office weighed heavy.

Behind the scenes, too, the pure president was caving in to the allurements of his job. Bribes were offered by a wealthy sports-shoe manufacturer in Pusan, which Mr Roh had represented. It was alleged that Mr Roh's wife, his childhood sweetheart, had taken $1m, and his son-in-law $5m. After he left office, the police said they wished to question him. Mr Roh denied that anything untoward had happened.

In April, however, he used his blog to make a statement headed "I Apologise". Mr Roh said his "household" had received the money to help settle a debt. "I feel ashamed before my fellow citizens," said Mr Roh. "I am sorry for having disappointed you." He had not been such a bad president as far as foreign policy or the economy went. But those efforts suddenly counted for nothing.

On May 23rd he went hiking, as he often did, in the hills above Bongha at dawn. Earlier in the spring fire had swept through the new green woods, blackening them. Before he left the house, and before he jumped from a high cliff into a ravine, he had left a note to his family on his computer. He said he had "made the life of too many people difficult". But "Don't be too sad. Isn't life and death all part of nature? Don't be sorry. Don't blame anybody. It's fate. Please cremate me. And please leave a small tombstone near home. I've long thought about that."

# Overview

May 28th 2009
From The Economist print edition

Americans felt surprisingly cheery in May. Consumer confidence surged from 40.8 to 54.9 on the index published by the Conference Board, a research firm. House prices in **America** fell by 19.1% in the year to the first quarter, on the S&P/Case-Shiller national house-price index. Lower prices may be tempting buyers back to the market. Sales of existing homes rose by 2.9% in April.

German businessmen were slightly less gloomy in May than in April. The index of business sentiment from Ifo, a research institute based in Munich, edged up from 83.7 to 84.2. GDP in **Germany** fell by 3.8% in the first quarter, unrevised from an earlier estimate. More than half of the drop was down to the weakness of net exports. A collapse in business spending on plant and machinery accounted for much of the rest. Consumption rose by a healthy 0.5% from the previous quarter.

**South Africa's** GDP fell at an annualised rate of 6.4% in the three months to March, following a smaller drop in the previous quarter. Its mining industry shrank at the fastest rate since records began in 1960.

The National Bank of **Poland** kept its benchmark interest rate unchanged at 3.75% on May 27th, but announced a reduction in the ratio of cash reserves it required from commercial banks, from 3.5% to 3%. **Hungary's** central bank kept its main interest rate on hold at 9.5%, but analysts reckon the recent revival of the forint may allow cuts in interest rates later this year.

Economist.com MARKETS & DATA WEEKLY INDICATORS

# Output, prices and jobs

May 28th 2009
From The Economist print edition

## Output, prices and jobs

% change on year ago

| | Gross domestic product | | | | Industrial production | Consumer prices | | | Unemployment |
|---|---|---|---|---|---|---|---|---|---|
| | latest | qtr* | 2009† | 2010† | latest | latest | year ago | 2009† | rate‡, % |
| United States | −2.6 Q1 | −6.1 | −2.9 | +1.4 | −12.5 Apr | −0.7 Apr | +3.9 | −0.8 | 8.9 Apr |
| Japan | −9.7 Q1 | −15.2 | −6.4 | +0.6 | −34.2 Mar | −0.3 Mar | +1.2 | −1.1 | 4.8 Mar |
| China | +6.1 Q1 | na | +6.5 | +7.3 | +7.3 Apr | −1.5 Apr | +8.5 | −0.5 | 9.0 2008 |
| Britain | −4.1 Q1 | −7.4 | −3.7 | +0.3 | −12.4 Mar | +2.3 Apr§ | +3.0 | +1.5 | 7.1 Mar†† |
| Canada | −0.7 Q4 | −3.4 | −2.3 | +1.6 | −7.6 Feb | +0.4 Apr | +1.7 | +0.5 | 8.0 Apr |
| Euro area | −4.6 Q1 | −9.8 | −3.7 | +0.3 | −20.2 Mar | +0.6 Apr | +3.3 | +0.4 | 8.9 Mar |
| Austria | −2.9 Q1 | −10.6 | −2.1 | +0.2 | −14.3 Mar | +0.7 Apr | +3.3 | +0.6 | 4.5 Mar |
| Belgium | −3.0 Q1 | −6.2 | −3.0 | +0.2 | −18.6 Feb | +0.6 Apr | +4.2 | +0.6 | 11.2 Feb‡‡ |
| France | −3.2 Q1 | −4.7 | −2.9 | +0.3 | −15.8 Mar | +0.1 Apr | +3.0 | +0.2 | 8.8 Mar |
| Germany | −6.9 Q1 | −14.4 | −5.2 | +0.3 | −20.3 Mar | nil May | +3.0 | +0.2 | 8.3 Apr |
| Greece | +0.3 Q1 | −4.6 | −3.1 | −0.7 | −5.3 Mar | +1.0 Apr | +4.4 | +0.4 | 9.1 Feb |
| Italy | −5.9 Q1 | −9.4 | −4.0 | +0.1 | −23.8 Mar | +1.2 Apr | +3.3 | +0.7 | 6.9 Q4 |
| Netherlands | −4.5 Q1 | −10.7 | −3.1 | +0.5 | −12.1 Mar | +1.8 Apr | +2.0 | +0.9 | 4.4 Apr†† |
| Spain | −3.0 Q1 | −7.4 | −3.3 | −0.5 | −14.0 Mar | −0.8 May | +4.6 | −0.1 | 17.4 Mar |
| Czech Republic | +0.7 Q4 | −3.7 | −3.0 | +1.2 | −17.0 Mar | +1.8 Apr | +6.8 | +1.9 | 7.9 Apr |
| Denmark | −3.7 Q4 | −7.3 | −3.1 | +0.6 | −15.0 Mar††† | +1.4 Apr | +3.2 | +1.2 | 2.9 Mar |
| Hungary | −6.4 Q1 | −8.9 | −6.0 | −1.0 | −19.6 Mar | +3.4 Apr | +6.6 | +3.0 | 9.9 Apr†† |
| Norway | +1.5 Q1 | −1.8 | −2.0 | +0.5 | −1.6 Mar | +2.9 Apr | +3.1 | +1.9 | 3.1 Feb*** |
| Poland | +2.9 Q4 | na | −0.8 | +1.5 | −12.4 Apr | +4.0 Apr | +4.0 | +3.0 | 11.0 Apr‡‡ |
| Russia | −9.5 Q1 | na | −5.0 | +2.0 | −16.9 Apr | +13.2 Apr | +14.3 | +13.6 | 10.0 Mar‡‡ |
| Sweden | −4.9 Q4 | −9.3 | −4.1 | +0.8 | −22.9 Mar | +0.1 Apr | +3.4 | −0.2 | 8.3 Apr‡‡ |
| Switzerland | −0.1 Q4 | −1.2 | −2.4 | +0.2 | −6.0 Q4 | −0.3 Apr | +2.3 | −0.5 | 3.4 Apr |
| Turkey | −6.2 Q4 | na | −4.5 | +1.0 | −20.9 Mar | +6.1 Apr | +9.7 | +6.8 | 16.1 Q1‡‡ |
| Australia | +0.3 Q4 | −2.1 | −0.7 | +1.6 | −0.7 Q4 | +2.5 Q1 | +4.2 | +2.0 | 5.4 Apr |
| Hong Kong | −7.8 Q1 | −16.1 | −5.8 | +0.6 | −10.3 Q4 | +0.6 Apr | +5.4 | +1.1 | 5.3 Apr†† |
| India | +5.3 Q4 | na | +5.0 | +6.4 | −2.3 Mar | +8.0 Mar | +7.9 | +5.0 | 6.8 2008 |
| Indonesia | +4.4 Q1 | na | +2.4 | +3.2 | +1.6 Mar | +7.3 Apr | +6.8 | +3.9 | 8.4 Aug |
| Malaysia | −6.2 Q1 | na | −3.0 | +1.2 | −14.3 Mar | +3.0 Apr | +3.0 | −0.5 | 3.0 Q4 |
| Pakistan | +5.8 2008** | na | −0.9 | +2.0 | −7.9 Feb | +17.2 Apr | +17.2 | +12.6 | 5.6 2007 |
| Singapore | −10.1 Q1 | −14.6 | −8.8 | +1.0 | −0.5 Apr | −0.7 Apr | +7.5 | −0.2 | 3.2 Q1 |
| South Korea | −4.3 Q1 | +0.2 | −6.0 | +0.4 | −10.6 Mar | +3.6 Apr | +4.1 | +1.4 | 3.7 Apr |
| Taiwan | −10.2 Q1 | na | −6.5 | +0.4 | −19.5 Apr | −0.5 Apr | +3.9 | −1.3 | 5.8 Apr |
| Thailand | −7.1 Q1 | −7.3 | −4.4 | +1.1 | −15.4 Mar | −0.9 Apr | +6.2 | −1.1 | 1.9 Mar |
| Argentina | +4.9 Q4 | −1.2 | −3.5 | +0.5 | −1.2 Apr | +5.7 Apr | +8.9 | +7.2 | 8.4 Q1‡‡ |
| Brazil | +1.3 Q4 | −13.6 | −1.5 | +2.7 | −10.0 Mar | +5.5 Apr | +5.0 | +4.4 | 8.9 Apr‡‡ |
| Chile | −2.1 Q1 | −2.4 | −0.8 | +2.0 | −7.1 Mar | +4.5 Apr | +8.3 | +3.1 | 9.2 Mar††‡‡ |
| Colombia | −0.7 Q4 | −4.1 | −2.0 | +1.8 | +0.4 Mar | +5.7 Apr | +5.7 | +5.2 | 12.0 Mar‡‡ |
| Mexico | −8.2 Q1 | −21.5 | −4.4 | +1.2 | −6.7 Mar | +6.2 Apr | +4.6 | +5.1 | 5.3 Apr‡‡ |
| Venezuela | +0.3 Q1 | na | −5.0 | −5.4 | −0.9 Jan | +29.4 Apr | +29.3 | +30.3 | 8.1 Q1‡‡ |
| Egypt | +4.3 Q1 | na | +3.4 | +3.1 | +5.7 Q4 | +11.7 Apr | +16.4 | +9.1 | 9.4 Q1‡‡ |
| Israel | +1.1 Q1 | −3.6 | −0.9 | +2.0 | −7.7 Mar | +3.1 Apr | +4.7 | +1.5 | 7.6 Q1 |
| Saudi Arabia | +4.2 2008 | na | −1.0 | +3.3 | na | +5.2 Apr | +9.2 | +4.3 | na |
| South Africa | −1.3 Q1 | −6.4 | −1.8 | +3.1 | +8.5 Mar | +8.4 Apr | +11.1 | +6.6 | 23.5 Mar‡‡ |
| **MORE COUNTRIES** Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | | | |
| Estonia | −15.6 Q1 | na | −10.0 | −2.5 | −29.7 Mar | +0.3 Apr | +11.4 | +0.5 | 11.1 Mar |
| Finland | −2.4 Q4 | −5.0 | −5.7 | −1.1 | −16.5 Mar | +0.8 Apr | +3.6 | +0.3 | 8.2 Apr |
| Iceland | −1.3 Q4 | −3.6 | −12.0 | −0.7 | +0.4 2007 | +11.6 May | +12.3 | +12.5 | 9.1 Apr‡‡ |
| Ireland | −7.5 Q4 | −25.7 | −7.4 | −2.5 | −1.7 Feb | −3.5 Apr | +4.3 | −3.5 | 11.4 Apr |
| Latvia | −18.0 Q1 | na | −15.0 | −4.0 | −23.4 Mar | +6.4 Apr | +17.4 | +2.5 | 16.1 Mar |
| Lithuania | −13.6 Q1 | −35.8 | −10.0 | −2.5 | na | +6.3 Apr | +11.7 | +4.5 | 9.5 Mar‡‡ |
| Luxembourg | −5.2 Q4 | −16.8 | −4.1 | −0.5 | −36.1 Feb | +0.3 Mar | +3.5 | +0.5 | 5.5 Mar‡‡ |
| New Zealand | −2.3 Q4 | −2.3 | −2.9 | +0.5 | −7.2 Q4 | +3.0 Q1 | +3.4 | +1.4 | 5.0 Q1 |
| Peru | +0.2 Feb | na | +1.3 | +2.5 | −7.4 Feb | +4.6 Apr | +5.5 | +4.1 | 9.3 Mar‡‡ |
| Philippines | +4.5 Q4 | +4.1 | −1.9 | +1.3 | −21.1 Feb | +4.8 Apr | +8.3 | +2.7 | 7.7 Q1‡‡ |
| Portugal | −3.7 Q1 | −8.5 | −4.0 | −0.3 | −7.6 Mar | −0.5 Apr | +2.5 | −0.7 | 8.9 Q1‡‡ |
| Slovakia | −5.4 Q1 | na | −2.0 | +1.0 | −18.0 Mar | +2.3 Apr | +4.2 | +2.0 | 10.9 Apr‡‡ |
| Slovenia | −0.8 Q4 | na | −3.0 | +1.1 | −18.5 Mar | +1.1 Apr | +6.5 | +1.1 | 8.4 Mar‡‡ |
| Ukraine | +6.9 Q3 | na | −6.0 | +2.0 | −31.8 Apr | +15.6 Apr | +30.2 | +16.5 | 2.9 Apr |
| Vietnam | +5.5 Q4 | na | +1.6 | +4.0 | +5.4 Apr | +9.2 Apr | +21.4 | +5.4 | 4.6 2007 |

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate -1.2 in Apr. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average †††New series

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

# *The Economist* commodity-price index

May 28th 2009
From The Economist print edition

## *The Economist* commodity-price index

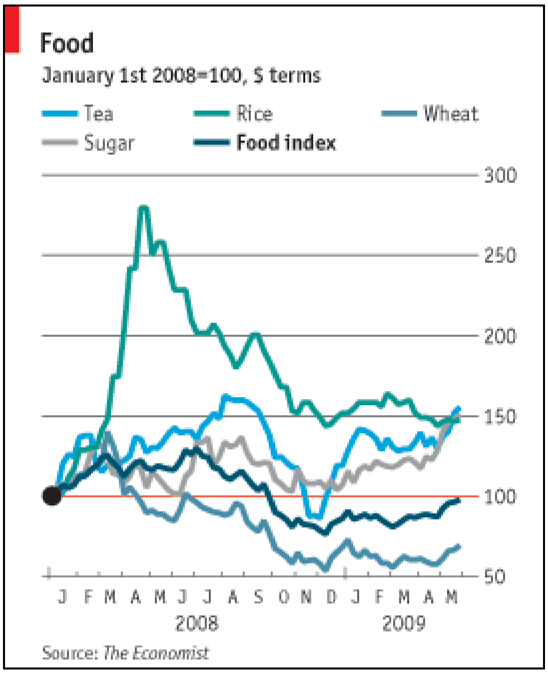
2000=100

| | May 19th | May 26th* | % change on one month | % change on one year |
|---|---|---|---|---|
| **Dollar index** | | | | |
| All items | 181.8 | 182.4 | +10.6 | -28.4 |
| Food | 208.1 | 211.3 | +12.3 | -16.2 |
| Industrials | | | | |
| All | 147.9 | 145.1 | +7.5 | -43.8 |
| Nfa† | 129.0 | 129.7 | +8.0 | -37.1 |
| Metals | 158.2 | 153.5 | +7.3 | -46.4 |
| **Sterling index** | | | | |
| All items | 177.8 | 173.5 | +1.7 | -11.3 |
| **Euro index** | | | | |
| All items | 123.5 | 120.6 | +3.4 | -19.5 |
| **Gold** | | | | |
| $ per oz | 926.20 | 958.80 | +7.7 | +5.4 |
| **West Texas Intermediate** | | | | |
| $ per barrel | 59.52 | 62.48 | +27.3 | -51.4 |

*Provisional †Non-food agriculturals.

# Food

May 28th 2009
From The Economist print edition




World food prices are 2.2% lower now than they were at the beginning of 2008, according to *The Economist*'s food-price index, which has fallen by nearly a quarter since its peak in July last year. The price of wheat, which has the largest weight in the index, is now nearly a third below its January 2008 level. Rice prices, which had risen to over two-and-a-half times their level at the beginning of 2008 by the end of April last year, have now fallen to just over half that level. But rice is still nearly one-and-a-half times as expensive as it was at the beginning of 2008. A steady rise in the price of sugar over the past month means that it is now more expensive than it has been at any point since the beginning of last year.

# Trade, exchange rates, budget balances and interest rates

May 28th 2009
From The Economist print edition

## Trade, exchange rates, budget balances and interest rates

| | Trade balance* latest 12 months, $bn | Current-account balance latest 12 months, $bn | Current-account balance % of GDP 2009† | Currency units, per $ May 27th | Currency units, per $ year ago | Budget balance % of GDP 2009† | Interest rates, % 3-month latest | Interest rates, % 10-year gov't bonds, latest |
|---|---|---|---|---|---|---|---|---|
| United States | −730.4 Mar | −673.3 Q4 | −3.3 | – | – | −13.2 | 0.25 | 3.70 |
| Japan | +10.0 Mar | +118.2 Mar | +1.6 | 95.1 | 105 | −6.3 | 0.47 | 1.47 |
| China | +300.5 Apr | +400.7 Q2 | +6.9 | 6.83 | 6.94 | −3.5 | 1.22 | 3.26 |
| Britain | −156.7 Mar | −44.6 Q4 | −1.7 | 0.62 | 0.50 | −13.8 | 1.25 | 3.73 |
| Canada | +32.7 Mar | +11.3 Q4 | −2.0 | 1.11 | 0.99 | −2.3 | 0.19 | 3.65 |
| Euro area | −56.8 Mar | −145.2 Mar | −1.0 | 0.72 | 0.64 | −5.7 | 1.27 | 3.56 |
| Austria | −3.9 Feb | +15.0 Q4 | +1.7 | 0.72 | 0.64 | −4.6 | 1.27 | 4.22 |
| Belgium | +5.0 Feb | −12.1 Dec | −1.8 | 0.72 | 0.64 | −4.7 | 1.29 | 4.17 |
| France | −79.1 Mar | −53.6 Mar | −2.3 | 0.72 | 0.64 | −6.6 | 1.27 | 3.95 |
| Germany | +223.3 Mar | +193.7 Mar | +4.4 | 0.72 | 0.64 | −4.4 | 1.27 | 3.56 |
| Greece | −61.1 Feb | −46.7 Mar | −8.8 | 0.72 | 0.64 | −6.0 | 1.27 | 5.35 |
| Italy | −14.9 Mar | −70.6 Mar | −2.6 | 0.72 | 0.64 | −5.3 | 1.27 | 4.45 |
| Netherlands | +47.6 Mar | +65.3 Q4 | +5.9 | 0.72 | 0.64 | −4.1 | 1.27 | 4.00 |
| Spain | −117.2 Mar | −144.9 Feb | −6.9 | 0.72 | 0.64 | −9.6 | 1.27 | 4.27 |
| Czech Republic | +4.0 Mar | −7.2 Mar | −2.1 | 19.2 | 16.1 | −4.0 | 2.21 | 5.34 |
| Denmark | +7.0 Mar | +8.0 Mar | +1.0 | 5.34 | 4.77 | −2.5 | 2.57 | 3.95 |
| Hungary | +0.1 Mar | −13.0 Q4 | −3.0 | 203 | 155 | −2.9 | 9.67 | 10.46 |
| Norway | +70.1 Apr | +83.4 Q4 | +10.5 | 6.41 | 5.04 | 10.5 | 2.20 | 4.28 |
| Poland | −20.2 Mar | −22.0 Mar | −5.2 | 3.19 | 2.17 | −3.8 | 4.62 | 6.34 |
| Russia | +142.3 Apr | +75.4 Q1 | −0.6 | 31.2 | 23.6 | −8.4 | 12.00 | 11.10 |
| Sweden | +13.1 Apr | +40.3 Q4 | +7.1 | 7.65 | 5.98 | −4.7 | 0.37 | 3.68 |
| Switzerland | +18.0 Apr | +53.3 Q4 | +7.5 | 1.09 | 1.04 | −2.0 | 0.40 | 2.41 |
| Turkey | −58.1 Mar | −30.5 Mar | −1.3 | 1.56 | 1.23 | −5.3 | 10.08 | 6.48‡ |
| Australia | +5.2 Mar | −44.1 Q4 | −5.0 | 1.27 | 1.04 | −3.3 | 3.16 | 5.39 |
| Hong Kong | −23.8 Apr | +30.5 Q4 | +7.8 | 7.75 | 7.81 | −4.3 | 0.37 | 2.50 |
| India | −109.0 Mar | −37.5 Q4 | −3.0 | 47.7 | 42.7 | −7.7 | 3.27 | 7.31 |
| Indonesia | +7.3 Mar | −0.8 Q1 | +0.5 | 10,310 | 9,300 | −3.2 | 8.10 | 7.92‡ |
| Malaysia | +43.5 Mar | +39.1 Q4 | +11.5 | 3.50 | 3.24 | −8.2 | 2.09 | 2.86‡ |
| Pakistan | −17.8 Apr | −15.3 Q4 | −1.2 | 80.6 | 67.8 | −5.6 | 13.72 | 16.31† |
| Singapore | +17.1 Apr | +27.1 Q4 | +17.2 | 1.45 | 1.36 | −4.1 | 0.50 | 2.18 |
| South Korea | +3.3 Apr | +7.4 Mar | +1.2 | 1,270 | 1,037 | −5.6 | 2.41 | 5.00 |
| Taiwan | +11.2 Apr | +29.2 Q1 | +9.7 | 32.5 | 30.5 | −5.0 | 0.85 | 1.41 |
| Thailand | +7.8 Mar | +5.9 Mar | +2.7 | 34.4 | 32.4 | −4.7 | 1.40 | 3.02 |
| Argentina | +14.4 Apr | +7.6 Q4 | +2.0 | 3.74 | 3.12 | −0.9 | 14.56 | na |
| Brazil | +27.0 Apr | −19.8 Apr | −1.2 | 2.01 | 1.67 | −2.0 | 10.16 | 6.16‡ |
| Chile | +3.8 Apr | −3.4 Q4 | −1.8 | 565 | 480 | −3.3 | 1.56 | 3.34‡ |
| Colombia | +2.1 Feb | −6.8 Q4 | −3.9 | 2,209 | 1,767 | −3.4 | 6.11 | 6.03‡ |
| Mexico | −16.2 Apr | −14.2 Q1 | −3.1 | 13.2 | 10.3 | −5.3 | 5.09 | 7.86 |
| Venezuela | +32.5 Q1 | +26.2 Q1 | +0.4 | 6.47 | 3.15§ | −5.3 | 16.00 | 6.55‡ |
| Egypt | −26.8 Q4 | −1.3 Q4 | −0.8 | 5.62 | 5.36 | −7.0 | 10.18 | 3.79† |
| Israel | −12.0 Mar | +1.6 Q4 | +2.0 | 3.97 | 3.29 | −5.8 | 0.46 | 4.33 |
| Saudi Arabia | +197.4 2008 | +124.0 2008 | −8.4 | 3.75 | 3.75 | −9.0 | 0.84 | na |
| South Africa | −7.4 Mar | −21.0 Q4 | −5.6 | 8.14 | 7.68 | −4.0 | 7.35 | 8.67 |
| **MORE COUNTRIES** Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | | |
| Estonia | −2.9 Mar | −1.6 Mar | −3.0 | 11.2 | 10.0 | −3.5 | 6.27 | na |
| Finland | +7.5 Mar | +2.5 Mar | +0.6 | 0.72 | 0.64 | −2.6 | 1.26 | 4.04 |
| Iceland | +0.2 Apr | −5.6 Q4 | +2.4 | 126 | 73.7 | −12.0 | 7.50 | na |
| Ireland | +45.0 Feb | −12.7 Q4 | −2.6 | 0.72 | 0.64 | −12.5 | 1.27 | 5.37 |
| Latvia | −5.0 Mar | −3.0 Mar | −2.0 | 0.51 | 0.45 | −6.0 | 11.94 | na |
| Lithuania | −5.4 Mar | −3.6 Mar | −3.0 | 2.48 | 2.21 | −3.5 | 6.92 | na |
| Luxembourg | −7.8 Feb | +3.0 Q4 | na | 0.72 | 0.64 | −3.5 | 1.27 | na |
| New Zealand | −2.9 Apr | −11.3 Q4 | −6.6 | 1.60 | 1.28 | −6.2 | 4.05 | 5.84 |
| Peru | +2.0 Mar | −4.2 Q4 | −5.5 | 3.01 | 2.86 | −1.6 | 4.00 | na |
| Philippines | −7.2 Mar | +4.2 Dec | +2.3 | 47.3 | 43.7 | −2.8 | 4.19 | na |
| Portugal | −33.0 Feb | −27.0 Mar | −9.9 | 0.72 | 0.64 | −6.0 | 1.27 | 4.36 |
| Slovakia | −1.0 Mar | −6.0 Mar | −6.3 | 21.6 | 19.7 | −4.5 | 1.35 | 4.93 |
| Slovenia | −4.1 Mar | −2.5 Feb | −1.6 | 0.72 | 0.64 | −3.8 | 1.27 | na |
| Ukraine | −16.9 Q4 | −9.8 Q1 | −0.3 | 7.63 | 4.73 | −4.3 | 10.20 | na |
| Vietnam | −6.2 Apr | −7.0 2007 | −0.5 | 17,773 | 16,219 | −8.2 | 8.00 | 7.16 |

*Merchandise trade only. †The Economist poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.

# Markets

May 28th 2009
From The Economist print edition

## Markets

| | Index May 27th | % change on one week | % change on Dec 31st 2008 in local currency | % change on Dec 31st 2008 in $ terms |
|---|---|---|---|---|
| United States (DJIA) | 8,300.0 | -1.4 | -5.4 | -5.4 |
| United States (S&P 500) | 893.1 | -1.2 | -1.1 | -1.1 |
| United States (NAScomp) | 1,731.1 | +0.2 | +9.8 | +9.8 |
| Japan (Nikkei 225) | 9,438.8 | +1.0 | +6.5 | +1.5 |
| Japan (Topix) | 892.9 | +0.7 | +3.9 | -1.0 |
| China (SSEA) | 2,763.5 | -0.7 | +44.6 | +44.4 |
| China (SSEB, $ terms) | 174.9 | -0.4 | +57.8 | +57.7 |
| Britain (FTSE 100) | 4,416.2 | -1.2 | -0.4 | +11.1 |
| Canada (S&P TSX) | 10,142.2 | -0.9 | +12.8 | +25.4 |
| Euro area (FTSE Euro 100) | 764.5 | -0.4 | +2.4 | +2.7 |
| Euro area (DJ STOXX 50) | 2,479.5 | -0.3 | +1.3 | +1.5 |
| Austria (ATX) | 2,042.5 | -3.1 | +16.7 | +16.9 |
| Belgium (Bel 20) | 2,084.5 | -1.1 | +9.2 | +9.4 |
| France (CAC 40) | 3,294.9 | -0.3 | +2.4 | +2.6 |
| Germany (DAX)* | 5,000.8 | -0.8 | +4.0 | +4.2 |
| Greece (Athex Comp) | 2,294.8 | -0.6 | +28.5 | +28.7 |
| Italy (S&P/MIB) | 20,312.0 | -1.0 | +4.4 | +4.6 |
| Netherlands (AEX) | 264.2 | -0.8 | +7.4 | +7.6 |
| Spain (Madrid SE) | 984.5 | +1.3 | +0.9 | +1.1 |
| Czech Republic (PX) | 910.3 | -3.9 | +6.1 | +6.7 |
| Denmark (OMXCB) | 277.4 | -3.1 | +22.6 | +22.9 |
| Hungary (BUX) | 15,706.7 | -0.6 | +28.3 | +20.8 |
| Norway (OSEAX) | 334.7 | -1.7 | +23.9 | +35.3 |
| Poland (WIG) | 29,775.4 | -1.8 | +9.4 | +1.7 |
| Russia (RTS, $ terms) | 1,030.8 | +0.7 | +66.4 | +63.1 |
| Sweden (OMXS30)† | 773.7 | -1.3 | +16.8 | +20.7 |
| Switzerland (SMI) | 5,419.4 | -1.6 | -2.1 | -4.0 |
| Turkey (ISE) | 35,168.7 | +0.1 | +30.9 | +29.8 |
| Australia (All Ord.) | 3,795.3 | -0.4 | +3.7 | +14.0 |
| Hong Kong (Hang Seng) | 17,885.3 | +2.3 | +24.3 | +24.3 |
| India (BSE) | 14,109.6 | +0.3 | +46.3 | +49.4 |
| Indonesia (JSX) | 1,892.8 | +0.4 | +39.7 | +47.6 |
| Malaysia (KLSE) | 1,047.7 | +0.5 | +19.5 | +18.0 |
| Pakistan (KSE) | 7,188.8 | +1.8 | +22.6 | +20.4 |
| Singapore (STI) | 2,306.1 | +1.6 | +30.9 | +30.1 |
| South Korea (KOSPI) | 1,362.0 | -5.1 | +21.1 | +20.2 |
| Taiwan (TWI) | 6,890.4 | +2.8 | +50.1 | +51.4 |
| Thailand (SET) | 555.4 | -1.1 | +23.4 | +24.9 |
| Argentina (MERV) | 1,567.4 | +1.1 | +45.2 | +34.1 |
| Brazil (BVSP) | 51,791.0 | +1.1 | +37.9 | +59.7 |
| Chile (IGPA) | 14,433.5 | +0.2 | +27.5 | +43.6 |
| Colombia (IGBC) | 9,129.1 | -1.4 | +20.7 | +22.9 |
| Mexico (IPC) | 24,507.8 | +0.4 | +9.5 | +15.3 |
| Venezuela (IBC) | 43,662.3 | +0.1 | +24.4 | +34.0 |
| Egypt (Case 30) | 5,869.4 | -1.1 | +27.7 | +25.2 |
| Israel (TA-100) | 791.0 | -0.5 | +40.2 | +33.5 |
| Saudi Arabia (Tadawul) | 5,771.0 | -4.5 | +20.2 | +20.2 |
| South Africa (JSE AS) | 22,521.7 | -0.7 | +4.7 | +18.9 |
| Europe (FTSEurofirst 300) | 870.6 | -0.6 | +4.6 | +4.9 |
| World, dev'd (MSCI) | 952.1 | -0.1 | +3.5 | +3.5 |
| Emerging markets (MSCI) | 754.2 | -0.2 | +33.0 | +33.0 |
| World, all (MSCI) | 242.0 | -0.2 | +6.3 | +6.3 |
| World bonds (Citigroup) | 790.4 | -0.1 | -2.4 | -2.4 |
| EMBI+ (JPMorgan) | 435.0 | -0.5 | +11.1 | +11.1 |
| Hedge funds (HFRX)§ | 1,067.6 | +0.1 | +4.6 | +4.6 |
| Volatility, US (VIX) | 32.4 | 29.0 | 40.0 | (levels) |
| CDSs, Eur (iTRAXX)‡ | 139.2 | +2.3 | -31.1 | -31.0 |
| CDSs, N Am (CDX)‡ | 196.9 | +2.8 | -15.6 | -15.6 |
| Carbon trading (EU ETS) € | 15.2 | -0.1 | -5.5 | -5.3 |

*Total return index. †New series. ‡Credit-default swap spreads, basis points. Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. §May 26th

# Digital music sales

May 28th 2009
From The Economist print edition

Over one-fifth of the music industry's worldwide revenues in 2008 came from sales of digital music, according to the International Federation of the Phonographic Industry, a trade body. The move away from physical formats like CDs is well advanced in America, the world's largest music market, where more than a third of the industry's revenue now comes from digital sales. The share of digital sales in other big markets such as Britain, Germany and Canada is less than half that in America. But although revenues from digital music were buoyant, rising by 24.1% in 2008, the global recession exacerbated an existing downward trend in the music industry's overall sales, which fell by 8.3% to $18.4 billion.